TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1931

No. 413

THE ÆTNA CASUALTY AND SURETY COMPANY,
PETITIONER,

vs.

PHŒNIX NATIONAL BANK AND TRUST COMPANY
OF LEXINGTON

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR CERTIORARI FILED SEPTEMBER 25, 1931

CERTIORARI GRANTED NOVEMBER 2, 1931

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[fol. 1] [Caption omitted]

[fol. 2]

IN CIRCUIT COURT OF FAYETTE COUNTY

PHŒNIX NATIONAL BANK AND TRUST COMPANY OF LEXINGTON, a Corporation, Plaintiff,

vs.

THE ÆTNA CASUALTY AND SURETY COMPANY, a Corporation, Defendant

PETITION—Filed February 3, 1926

The plaintiff, Phœnix National Bank and Trust Company, of Lexington, says that it is a corporation, created and incorporated under the law passed by Congress, known as the National Banking Act, with power to engage in the banking business, at Lexington, Kentucky, contract, sue and be sued in its said corporate name; that the defendant Ætna Casualty and Surety Company, is a corporation created and incorporated under the laws of the State of Connecticut, with power and authority to engage in the business of fidelity and guaranty insurance, and to issue policies or bonds, covering all contracts, in which it undertakes to and does engage in said business, and to contract, sue and be sued in said corporate name.

Plaintiff says that heretofore, to-wit, on the 14th day of November, 1923, for a valuable consideration paid to the said defendant by plaintiff herein, the defendant did issue and deliver to plaintiff one of defendant's contracts, policies or bonds, known as "Bankers' Blanket Bond, Standard Form No. 8, Bond No. 132522", in words and figures as follows, to-wit:

"The Ætna Casualty and Surety Company, Hartford, Connecticut, Morgan B. Brainard, President

Bankers' Blanket Bond (Standard Form No. 8)

Bond No: F-132522.
Amount: $25,000.00.

In Consideration of an annual premium, The Ætna Casualty and Surety Company, a corporation of the State of Connecticut, with its home office in the City of Hartford,

[fol. 3] hereinafter referred to as Underwriter, hereby undertakes and agrees to indemnify Phœnix National Bank and Trust Company, Lexington, Kentucky, hereinafter referred to as the Insured, and hold it harmless to an amount not exceeding Twenty-five Thousand and no/100ths Dollars, ($25,000.00) from and against any loss sustained by the Insured subsequent to noon of the date hereof and while this bond is in force and discovered by the Insured subsequent to noon of the date hereof and prior to the expiration of twelve months after the termination of this bond has provided in Condition 11 hereof, that is to say:

A. Any loss through any dishonest or criminal act of any of the Insured's officers, clerks or other employees employed in, at or by any of the Insured's offices covered hereunder during the currency of this bond (all such officers, clerks and other employees being hereinafter referred to as Employees), wherever committed and whether committed directly or by collusion with others.

B. Any loss of money, currency, bullion, bonds, debentures, scrip, certificates, warrants, transfers, coupons, bills of exchange, promissory notes, checks or other similar securities, in which the Insured has a pecuniary interest, or which are held by the Insured as collateral or as bailee, trustee, custodian, agent or in any other capacity, and whether or not the Insured is liable therefor (all of such money, currency, bullion, bonds, debentures, script, certificates, warrants, transfers, coupons, bills of exchange, promissory notes, checks or other similar securities being hereinafter referred to as Property), through robbery, larceny (whether common-law or Statutory), burglary, theft, hold-up, misplacement, or destruction, whether effected with or without violence or with or without negligence on the part of any of the Employees, while the Property is within any of the Insured's offices covered hereunder, or within any recognized places of safe deposit within the United States, or within the premises of any of the Insured's bankers, or lodged or deposited by the Insured in the ordinary course of business for exchange, conversion or registration with the issuers thereof or with any agents of such issuers, or with any persons employed to procure or manage the exchange, conversion or registration thereof.

C. Any loss of Property through misplacement, destruc-
[fol. 4] tion, robbery, larceny, (whether common-law or statutory), hold-up or theft, while such Property is in transit within the United States and in the custody of any of the Employees or any partner of the Insured, or through negligence, or otherwise, on the part of any of the Employees having custody of the Property, while in transit as aforesaid; such transit risk to begin immediately upon receipt of such Property by the transporting Employee or Employees or partner and to end immediately upon delivery thereof at destination.

D. Any loss through the payment, whether received over the counter or through the clearing house or by mail, of forged or raised checks or (genuine) checks bearing forged endorsements or the establishment of any credit to any customer on the faith of such checks.

The foregoing agreement is subject to the following conditions and Limitations:

1. The offices of the Insured which are covered hereunder are located as follows: Main Office: Lexington, Kentucky. Branches: None.

If the Insured shall give to the Underwriter notice that he desires any other office to be covered hereunder, then, if the Underwriter shall give its written consent thereto, such office shall be covered hereunder from and after the receipt of such notice, and an additional premium shall be paid. No notice to the Underwriter of an increase during any premium year in the number of Employees at any of the offices covered hereunder need be given, and no additional premium need be paid unless such increase shall result from the merger or combination with the Insured of another banking institution.

2. This bond does not cover:

a. Any loss effected by means of forgery, except when covered by insuring clauses (A) and (D) hereof.

b. Any loss resulting from riot, civil commotion (unless such loss result while the Property is in transit in the custody of an Employee or partner aforesaid and unless when such Employee or partner was dispatched there was no knowledge on the part of the Insured or any of its officers

or Partners of such riot or civil commotion), or insurrection, military or unsurped power, or from wind storm, [fol. 5] tornado, earthquake, volcanic eruption, or similar disturbance of nature.

c. Any loss resulting from any act or acts of any director of the Insured, other than one employed as a salaried official, or of any partner of the Insured.

d. Any loss resulting from any loan made by the Insured or by any of the Employees, whether authorized or unauthorized, unless such loan be made with intent on the part of such Employee to defraud the Insured.

e. Shortages in the teller's cash due to errors; and any such shortage not in excess of the normal shortage shall be assumed to be due to error.

f. Any loss of Property confided to the care of Insured, the nominal value and description of which have not been ascertained by the Insured before loss.

g. Any loss resulting from authorized or unauthorized transactions in Foreign Exchange arising out of fluctuations in such exchange.

h. Any loss of Property contained in customers' safe deposit boxes unless such loss be sustained through any dishonest act of an identifiable Employee under such circumstances as shall make the Insured legally liable therefor.

3. No statement made by or on behalf of the Insured, whether contained in the application or otherwise, shall be deemed to be a warranty of anything except that it is true to the best of the knowledge and belief of the person making the statement.

4. The Insured shall give to the Underwriter written notive of any loss hereunder as soon as possible after the Insured shall learn of such loss, and within ninety days after learning of such loss shall file with the Underwriter an itemized proof of claim duly sworn to.

5. The value of any securities for the loss of which claim shall be made hereunder shall be determined by the average market value of such securities on the day preceding the discovery of such loss. If such securities have no

quoted market value, their value shall be determined by agreement or by arbitration.

6. No action or proceeding shall be brought under this bond in regard to any loss, unless begun within twelve [fol. 6] months after the Insured shall learn of such loss, or, in case such limitation be void under the law of the place governing the construction hereof, then within the shortest period of limitation permitted by such law.

7. In case of recovery, whether made by the Insured or the Underwriter, on account of any loss hereunder, from any source other than insurance or suretyship, the net amount of such recovery, less the actual costs and expenses of making same, shall be applied to reimburse the Insured in full for such loss, and the excess, if any, shall be paid to the Underwriter; and the Insured shall execute all necessary papers to secure to the Underwriter the rights herein provided for.

8. The occurrence of any loss or losses hereunder and corresponding subsequent payment of such loss or losses shall not reduce the amount of this bond as to any other loss or losses hereunder, whether occurring before or after the loss or losses so paid: Provided, However, that in no event shall the Underwriter be liable on account of any one loss or series of losses caused by the acts or omissions of any Employee or other person, or combination of Employees or other persons, or caused by the same casualty or event for a greater sum than that specified in line 5 hereof; and Provided Further, that upon every sum so paid as a loss hereunder the Insured shall pay to the Underwriter, upon demand, an additional premium computed pro rata from the date of the giving by the Insured to the Underwriter of notice of the loss so paid to the end of the current premium year.

9. If the Insured shall, in the application for this bond, state its intention to carry fidelity suretyship upon any of the Employees, and shall, in the computation of the premium for this bond, receive credit for such suretyship, then, in case a loss shall be sustained through the dishonest act of any Employee covered, or stated to be covered, by such fidelity suretyship, the Underwriter shall be liable hereunder only for that part of such loss which is in excess of

the amount of fidelity suretyship carried or stated to be carried on such Employee.

10. If the Insured shall hold, as indemnity against any loss covered hereunder, any valid and enforceable security, or insurance other than the fidelity suretyship, if any, for [fol. 7] which credit has been given in accordance with the preceding section, the Underwriter shall be liable hereunder only for such proportion of such loss as the amount of this bond bears to the aggregate amount of this bond and such other security and insurance.

11. This bond shall terminate—(a) thirty days after the receipt of the Insured of a written notice from the Underwriter of its desire to terminate this bond, or (b) upon the receipt by the Underwriter of a written request from the Insured to terminate this bond. This bond shall terminate as to any Employee (a) as soon as the Insured shall learn of any default hereunder committed by such Employee, or (b) fifteen days after the receipt by the Insured of a written notice from the Underwriter of its desire to terminate this bond as to such Employee.

Signed, sealed and dated the 14th day of November, 1923.

The Aetna Casualty & Surety Company, by H. S. Betchelder, Resident Vice-President."

Attest: H. Johnson, Resident Assistant Secretary. (Seal.)

The plaintiff says that by agreement of the plaintiff herein and the defendant herein, the bond, contract or writing was to be in force from November 14, 1923, to April 8th, 1924, and thereafter, by agreement of the said parties, the same was to be in force annually to the 8th day of April, of each succeeding year as long as the annual premiums were paid on said bond; that by agreement of the parties, plaintiff and defendant herein, it was agreed that the premium payments would be paid on said bond and same were paid before their respective maturities, up to the 8th day of April, 1926, and that said bond, contract and writing is in full force and effect, and that the same has been continuously in full force and effect from the date that the same was signed, executed and delivered from defendant to plaintiff, on the 14th day of November, 1923.

Plaintiff says that by the terms of said bond, contract and agreement, it undertook to and did indemnify and save harmless the plaintiff herein, to the amount of Twenty-five Thousand ($25,000) Dollars, from and against any loss sus-[fol. 8] tained by the plaintiff herein, subsequent to noon, of November 14, 1923, and while said bond, contract and agreement was in force, and such loss as was discovered by the plaintiff herein subsequent to noon of said date, November 14, 1923, and prior to the expiration of twelve months after the termination of said bond; that is to say, the said defendant undertook to indemnify and save plaintiff harmless during said time and on said occasions from any loss through the payment, whether received over the counter or through the clearing house or by mail, of forged or raised checks or (genuine) checks bearing forged endorsements or the establishment of any credit to any customer on the faith of such checks.

Plaintiff says that thereafter, to-wit, while said bond, contract and agreement was alive and in full force and effect, and said guaranty and indemnity existed, it did suffer loss, as hereinafter stated, through payment and through the clearing house and over the counter, of forged and raised checks, and genuine checks bearing forged endorsements as follows, to-wit:

That heretofore, prior to May 12, 1924, on said date and continuously since said date down to the present time, one of the customers and depositors of the plaintiff herein was the Petroleum Company, a corporation, with its office located in Lexington, Kentucky.

That on the 12th day of May, 1924, the said Petroleum Company issued its check No. 1272, payable to one, Floyd B. Fitch, for the sum of .90 cts.; that thereafter, one, H. D. Fulton, fraudulently altered and raised said check and thereby increased the amount provided to be paid thereon from .90 cents, to $176.90, and in addition thereto, forged the name of Floyd B. Fitch on the back of said check, and cashed said check at the LaFayette Hotel Company; that said check was thereafter paid to the LaFayette Hotel Company by the Bank of Commerce, Lexington, Ky., and same was thereafter paid by the plaintiff herein, on June 17, 1924, and plaintiff charged same to the account of said Petroleum Company.

That on June 21, 1924, the said Petroleum Company issued its check No. 1277, payable to Floyd B. Fitch, for the sum of $17.90; that thereafter, said H. D. Fulton fraudulently altered and raised said check and thereby increased the amount provided to be paid thereon, from $17.90, to $317.90, and in addition thereto, forged the name of F. B. Fitch on the back of said check, and cashed said check at the LaFayette Hotel Company, that said check was thereafter paid to the LaFayette Hotel Company by the Bank [fol. 9] of Commerce, Lexington Ky., and same was thereafter paid by the plaintiff, on June 24, 1924, and plaintiff charged same to account of said Petroleum Company.

That on June 15, 1924, the said Petroleum Company issued its check No. 1296, payable to Floyd Shellito, for the sum of $100.00, that thereafter, said H. D. Fulton forged the name of Floyd Shellito, on the back of said check, and cashed said check at the LaFayette Hotel Company, that said check was thereafter paid to the LaFayette Hotel Company by the Bank of Commerce, Lexington, Ky., and same was paid by plaintiff on August 5, 1924, and plaintiff charged same to account of Petroleum Company.

That on June 15, 1924, the Petroleum Company issued its check No. 1297, payable to Homer Thrawley, for $108.00, and that thereafter H. D. Fulton forged the name of H. Thrawley on the back of said check and cashed said check at the LaFayette Hotel Co. and said check was thereafter paid to the LaFayette Hotel Co. by the Bank of Commerce, and same was paid by plaintiff on June 28, 1924, and charged by plaintiff to account of Petroleum Company.

That on September 27, 1924, said Petroleum Company issued its check No. 1421, to Felix M. Miles for $482.80; that thereafter said H. D. Fulton forged the name of Felix M. Miles on back of said check, cashed said check at the LaFayette Hotel Co., and said check was thereafter paid to LaFayette Hotel Co. by the said Bank of Commerce and same was paid by plaintiff on October 4, 1924, and charged by plaintiff to account of Petroleum Company.

That on August 20, 1924, said Petroleum Company issued its check, No. 1445, payable to H. Thrawley, for $117.00; that thereafter said H. D. Fulton forged the name of H. Thrawley on the back of said check, cashed said check at the LaFayette Hotel Co., and said check was thereafter paid to the LaFayette Hotel Co. by the Bank of Commerce,

and same was paid by plaintiff on August 22, 1924, and charged by plaintiff to account of Petroleum Company.

That on August 25, 1924, the said Petroleum Company issued its check, No. 1486, payable to Robert Day for $25.00; that thereafter H. D. Fulton fraudulently altered and raised said check and thereby increased the amount provided to be paid thereon from $25.00, to $125.00, and in addition [fol. 10] thereto, forged the name of Robert Day on the back of said check, and cashed said check at the LaFayette Hotel Co., that said check was thereafter paid to the La Fayette Hotel Co. by the Bank of Commerce, and same was thereafter paid by plaintiff, on August 27, 1924, and charged by plaintiff to the account of the Petroleum Company.

That on August 25, 1924, the Petroleum Company issued its check No. 1501, payable to the order of Felix M. Miles, for the sum of $8.56; that thereafter, said H. D. Fulton fraudulently altered and raised said check and thereby increased the amount provided to be paid thereon, from $8.56, to $88.96, and in addition thereto, forged the name of Felix M. Miles on the back of said check, cashed said check at the La Fayette Hotel Co., that said check was thereafter paid to La Fayette Hotel Co. by the Bank of Commerce, and same was paid by the Plaintiff on August 28, 1924, and charged by plaintiff to the account of the Petroleum Company.

That on August 29, 1924, the Petroleum Company issued its check No. 1515, to Floyd B. Fitch, for the sum of $1.88; that thereafter, said H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon, from $1.88, to $81.88, and in addition thereto forged the name of Floyd B. Fitch on the back of said check, cashed said check at the La Fayette Hotel Company, that said check was thereafter paid to the La Fayette Hotel Co. by the Bank of Commerce, and same was paid by plaintiff on September 3, 1924, and charged by plaintiff to the account of the Petroleum Company.

That on September 13, 1924, the Petroleum Company issued its check, No. 1563, payable to H. O. Randel, for $34.00; that thereafter H. D. Fulton forged the name of H. O. Randel on the back of said check, cashed said check at the La Fayette Hotel Co. and said check was thereafter paid to the La Fayette Hotel Co. by the Guaranty Bank & Trust

Co., and same was paid by plaintiff on September 18, 1924, and charged by plaintiff to account of said Petroleum Company.

That on October 15, 1924, the Petroleum Company issued its check No. 1655, payable to Floyd Shellito, for $100.00; that thereafter said H. D. Fulton forged the name of Floyd Shellito on the back of said check, cashed said check at the La Fayette Hotel Co., and said check was thereafter paid to the La Fayette Hotel Co. by the Bank of Commerce, and same was paid by the plaintiff on October 24, 1924, and charged by plaintiff to account of Petroleum Company.

[fol. 11] That on October 15, 1924, the Petroleum Company issued its check No. 1656, payable to Homer Thrawley, for $117.00; that thereafter H. D. Fulton forged the name of Homer Thrawley on the back of said check, cashed said check at the La Fayette Hotel Co., and said check was paid the La Fayette Hotel Co. by the Bank of Commerce; and said check was paid by plaintiff on October 22, 1924, and charged by it to the account of the Petroleum Company.

That on October 29, 1924, the Petroleum Company issued its check No. 1659, to John B. Miles, for the sum of $1.20; that thereafter H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon, from $1.20, to $159.97, and in addition thereto forged the name of John B. Miles on the back of said check; and said check was paid by the plaintiff thereafter, to-wit, on November 7, 1924, and charged by plaintiff to the account of the Petroleum Company.

That on October 29, 1924, the Petroleum Company issued its check, No. 1660, payable to Floyd B. Fitch, for $1.20; that thereafter H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon, from $1.20, to $170.00, and in addition thereto forged the name of Floyd B. Fitch on the back of said check; and that thereafter the said check was paid by plaintiff on November 1, 1924, and charged by plaintiff to the account of the Petroleum Company.

That on November 4, 1924, the Petroleum Company issued its check, No. 1662, payable to Whitley Isaacs, for $10.00; that thereafter H. D. Fulton forged the name of Whitley Isaacs on the back of said check, cashed said check at the Blue Bird Taxi Co., and said check was paid the Blue

Bird Taxi Co., by the Guaranty Bank and Trust Co., and said check was paid by plaintiff on February 14, 1925, and charged by plaintiff to the account of the Petroleum Company.

That on November 4, 1924, the Petroleum Company issued its check, No. 1664, payable to Floyd B. Fitch, for $200.00; that thereafter H. D. Fulton forged the name of Floyd B. Fitch on the back of said check, cashed said check at the La Fayette Hotel Co., and said check was paid to the La Fayette Hotel Co. by the Bank of Commerce, and same was paid by plaintiff on November 6, 1924, and charged by plaintiff to the account of the Petroleum Company.

[fol. 12] That on November 3, 1924, the Petroleum Company issued its check, No. 1665, payable to L. F. Feely, for $250.00; that thereafter H. D. Fulton forged the name of L. F. Feeley on the back of said check, cashed said check at the La Fayette Hotel Co., and said check was paid to the La Fayette Hotel Co. by the Bank of Commerce, and same was paid by the plaintiff on November 8, 1924, and charged to the account of the Petroleum Company.

That on November 12, 1924, the Petroleum Company issued its check, No. 1681, payable to Carl Burgess, for $45.00; that thereafter H. D. Fulton forged the name of Carl Burgess on the back of said check, cashed said check at the La Fayette Hotel Co., and said check was paid to the La Fayette Hotel Co. by the Bank of Commerce; and same was paid by the plaintiff on November 15, 1924, and charged to the account of the Petroleum Company.

That on November 12, 1924, the Petroleum Company issued its check No. 1682, payable to Clifford Couch, for $45.00; that thereafter H. D. Fulton forged the name of Clifford Couch on the back of said check, cashed said check at the La Fayette Hotel Co., and said check was paid to the La Fayette Hotel Co. by the Bank of Commerce; and the same was paid by the plaintiff on November 14, 1924, and charged to the account of the Petroleum Company.

That on November 15, 1924, the Petroleum Company issued its check, No. 1685, payable to John Hale, for $105.00; that thereafter H. D. Fulton forged the name of John Hale on the back of said check, cashed said check at the La Fayette Hotel Co., and said check was paid to the La Fayette Hotel Co. by the Bank of Commerce; and same was paid by the plaintiff on November 25, 1924, and charged by plaintiff to the account of the Petroleum Company.

That on November 25, 1924, the Petroleum Company issued its check, No. 1705, payable to Floyd Shellito, for $1.25; that thereafter H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon, from $1.25, to $111.25, and in addition thereto, forged the name of Floyd Shellito on the back of said check, and cashed said check at the La Fayette Hotel Co., and said check was thereafter paid to the La Fayette Hotel Co. by the Bank of Commerce, and same was paid by the plaintiff on December 4, 1924, and charged to the account of the Petroleum Company.

That on December 16, 1924, the Petroleum Company [fol. 13] issued its check No. 1746, payable to Floyd B. Fitch, for $34.02; that thereafter H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon, from $34.02, to $134.02, and in addition thereto, forged the name of Floyd B. Fitch on the back of said check, cashed said check at the LaFayette Hotel Co., and said check was afterwards paid to the LaFayette Hotel Co. by the Bank of Commerce, and same was paid by plaintiff on December 30, 1924, and charged by plaintiff to the account of the Petroleum Company.

That on December 16, 1924, the Petroleum Company issued its check No. 1747, payable to Hugh E. Williamson, for $39.37; that thereafter H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon from $39.37, to $139.37, and in addition thereto, forged the name of Hugh E. Williamson on the back of said check, cashed said check at the La Fayette Hotel Co. and said check was afterwards paid to the LaFayette Hotel Co. by the Bank of Commerce, and the same was paid by plaintiff on December 16, 1924, and charged by plaintiff to the account of Petroleum Company.

That on December 16, 1924, the Petroleum Company issued its check, No. 1748, payable to Floyd B. Fitch, for $15.75; that thereafter H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon, from $15.75, to $115.75, and in addition thereto forged the name of Floyd B. Fitch on the back of said check, cashed said check at the LaFayette Hotel Co., and said check was afterwards paid to the La-

Fayette Hotel Co. by the Bank of Commerce, and the same was paid by plaintiff on December 23, 1924, and charged by it to the account of the Petroleum Company.

That on April 15, 1925, the Petroleum Company issued its check No. 1845, payable to Sam Hackworth, for $7.50; that thereafter H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon, from $7.50, to $77.50, and in addition thereto forged the name of Sam Hackworth on the back of said check, and the said check was paid by the plaintiff on May 22, 1925, and same was charged by the plaintiff to the account of the Petroleum Company.

That on April 15, 1925, the Petroleum Company issued its check, No. 1846, payable to The Model Oil Company, for $15.00; that thereafter H. D. Fulton fraudulently al- [fol. 14] tered and raised said check, thereby increasing the amount provided to be paid thereon, from $15.00, to $115.00, and in addition thereto forged the name of The Model Oil Company, by Henry Day, on the back of said check, and said check was paid by the plaintiff on May 26, 1925, and charged by it to the account of the Petroleum Company.

That on April 15, 1925, the Petroleum Company issued its check, No. 1847, payable to Homer Thrawley, for $114.92; that thereafter H. D. Fulton forged the name of Homer Thrawley on the back of said check, cashed said check at the LaFayette Hotel Co., and said check was paid to the LaFayette Hotel Co. by the Bank of Commerce; and same was paid by the plaintiff on May 9, 1925, and charged by the plaintiff to the account of the Petroleum Company.

That on April 15, 1925, the Petroleum Company issued its check No. 1848, payable to Robert Day, for $6.00; that thereafter H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon from $6.00 to $146.00, and in addition thereto forged the name of Robert Day on the back of said check, cashed said check at the LaFayette Hotel Co., and said check was paid to the LaFayette Hotel Co. by the Bank of Commerce; and same was paid by the plaintiff on April 22, 1925, and charged by it to the account of the Petroleum Company.

That on April 15, 1925, the Petroleum Company issued its check No. 1849, payable to Henry Day, for $30.00;

that thereafter H. D. Fulton forged the name of Henry Day on the back of said check, cashed said check at the LaFayette Hotel Co., and said check was paid to the LaFayette Hotel Co. by the Bank of Commerce; and same was paid by the plaintiff on May 14, 1925, and charged to the account of the Petroleum Company.

That on April 15, 1925, the Petroleum Company issued its check, No. 1850, payable to Ova Day, for $6.00; that thereafter H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid theeron from $6.00, to $66.00, and in addition thereto forged the name of Ova Day on the back of said check, cashed said check at the LaFayette Hotel Co., and said check was paid to the LaFayette Hotel Co., by the Bank of Commerce; and same was paid by the plaintiff on May 20, 1925, and charged by plaintiff to the account of the Petroleum Company.

That on April 20, 1925, the Petroleum Company issued [fol. 15] its Check No. 1854, payable to Cash for $1.50; that thereafter H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon from $1.50, to $150.00, cashed said check at the LaFayette Hotel Co., and said check was paid to the LaFayette Hotel Co. by the Bank of Commerce; and same was paid by the plaintiff on April 22, 1925, and charged by it to account of the Petroleum Company.

That on April 22, 1925, the Petroleum Company issued its check No. 1855, payable to G. Arthur Bush, for $3.00; that thereafter H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon from $3.00, to $225.00, and in addition thereto forged the name of G. Arthur Bush on the back of said check, cashed said check at the LaFayette Hotel Co., and said check was paid to the LaFayette Hotel Co. by the Bank of Commerce; and same was paid by plaintiff on April 28, 1925, and charged by it to the account of the Petroleum Company.

That on April 24, 1925, the Petroleum Company issued its check No. 1856, payable to J. D. Ruse for $90.00; that thereafter H. D. Fulton forged the name of J. D. Ruse on the back of said check, cashed said check at the LaFayette Hotel Co., and said check was paid to the LaFayette Hotel Co. by the Bank of Commerce, and same was

paid by the plaintiff on April 28, 1925, and charged by it to the account of the Petroleum Company.

That on May 15, 1925, the Petroleum Company issued its check No. 1904, payable to H. D. Fulton, for $12.50; that the said H. D. Fulton thereafter fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon, from $12.50, to $112.50, cashed said check at the LaFayette Hotel Co., and said check was paid to the LaFayette Hotel Co. by the Bank of Commerce, and same was paid by this plaintiff on May 18, 1925, and charged by it to the account of the Petroleum Company.

That on June 8, 1925, the Petroleum Company issued its check No. 1904, payable to H. D. Fulton, for $12.50; that thereafter the said H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon, from $12.50 to $72.50, cashed said check at the LaFayette Hotel Co., and said check was paid to the LaFayette Hotel Co. by the Bank of Commerce, and same was paid by the plaintiff on Jun[illegible] 10, 1925, and charged by it to the account of the Petrole[illegible] Company.

[fol. 16] That on the 22nd [illegible]y of June, 1925, the Petroleum Company issued its check, No. 1915, payable to H. D. Fulton for $12.50; that thereafter said H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon from $12.50 to $212.50; said check was paid by the plaintiff on June 23, 1925, and charged by it to the account of the Petroleum Company.

That on July 28, 1925, the Petroleum Company issued its check No. 1916, payable to Frank Rice, for $112.00; that thereafter H. D. Fulton forged the name of Frank Rice on the back of said check, cashed said check at the LaFayette Hotel Co., and said check was paid to the LaFayette Hotel Co. by the Bank of Commerce, and same was paid by plaintiff on August 1, 1925, and charged by it to the account of the Petroleum Company.

That on June 23, 1925, the Petroleum Company issued its check, No. 1918, payable to Glen Smith for $14.00; that thereafter H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon from $14.00, to $314.00, and in addition thereto forged the name of Glen Smith on the back of

said check, cashed said check, which was paid by the plaintiff on July 11, 1925, and charged by it to the account of the Petroleum Company.

That on June 23, 1925, the Petroleum Company issued its check, No. 1919, payable to Homer Thrawley, for $179.00; that thereafter H. D. Fulton fraudulently altered and raised said check, thereby increasing the amount provided to be paid thereon from $179.00, to $379.00, and said check was paid by the plaintiff on July 8, 1925, and charged by it to the account of the Petroleum Company.

That all of said checks, together with their written endorsements on the back thereof, are filed herewith, referred to and made part hereof marked as Exhibits herein and numbered in red ink on the back thereof, from 1, to 39, consecutively.

The plaintiff says that the total amount of said checks, altered and raised, as hereinabove set out, is the sum of $5512.72.

Plaintiff says that after said checks were so charged by it to the account of the said Petroleum Company, to-wit, on the 25th day of September, 1925, the said Petroleum Company made written demand on this plaintiff that it would credit the said Company's account with said checks, a list of which was then furnished by the said Petroleum Company to this plaintiff, and same is the list hereinbefore set out, and that said Petroleum Company [fol. 17] made demand that said checks should be credited to its accounts at once; that the said demand of the Petroleum Company was in writing; and that thereupon, on October 2, 1925, as soon as possible after the plaintiff learned of said loss, the plaintiff says that by its letter of said date to the defendant, it advised and stated to the defendant that said checks, as hereinbefore set out, had been forged and raised and were not genuine, that it had charged the same to the Petroleum Company's account, and that the Petroleum Company had demanded that said checks should be credited to its account, all of which facts were made known to, and of which the defendant was advised by the said plaintiff in its letter of said date of October 2, 1925, which letter is in words and figures as follows, to-wit:

"October 2nd, 1925.

"The Ætna Casualty and Surety Company, Hartford, Conn.

GENTLEMEN: We have your "Bankers' Blanket Bond" No. F-132522, and under said bond, you are hereby notified that on September 25, 1925, the Petroleum Company of this City, made demand on the undersigned to credit its account with the checks, a list of which is hereto attached, which have heretofore been charged to its account. Said demand being made, because said checks or the endorsements on said list indicated, were forged and not genuine, and the charges heretofore made against the Petroleum Company's account is alleged to be incorrect. The total of these checks is $5,512.72.

While these checks have not yet been credited back to the account of the Petroleum Company, the demand has been made that we should so credit said checks, and we will have to do so, as the information supplied to us indicates unquestionably that the statements, set out in the letter of the Petroleum Company to us, are true and correct. A copy of their letter and a list of the checks for which they demand credit, is attached hereto as part hereof, for your information.

Please give this matter your earliest consideration, and oblige,

Very truly yours, Phœnix National Bank and Trust Company, by W. H. Courtney, President."

[fol. 18] Plaintiff says that defendant received said communication above set forth, and on or about November 25, 1925, in writing, refused to pay said claim and denied any liability thereon.

Plaintiff says that thereafter the Petroleum Company again insisted and demanded that its said account should be credited with the said sum of $5,512.72, in accordance with its said previous demand, on September 25, 1925, hereinbefore referred to, and that this plaintiff did on the 14th day of January, 1926, credit the account of the said Petroleum Company with the sum of $5,512.72, pursuant to its said written demand, bearing date September, 1925; that on said January 14, 1926, the plaintiff so advised the

defendant herein, by writing in words and figures as follows, to-wit:

"January 14, 1926.

"The Ætna Casualty and Surety Company, Hartford, Conn.

GENTLEMEN: We have this day credited the Petroleum Company's account with $5512.72, pursuant to its written demand on us, bearing date September 25, 1925, a copy of which, together with itemized list of checks attached thereto, we inclosed to you with our letter of date October 2, 1925.

The basis of this claim against us, and for which it demanded its account should be credited, was forged and raised checks by which its funds were withdrawn from our bank by one, H. D. Fulton, at the times and in the amounts set forth in the itemized claim heretofore sent you, and a copy of which is now inclosed herewith.

As we have stated above, we have this day credited the Petroleum Company's account with this $5512.72, re-imbursement for which is now demanded by us from you, under your Bankers Blanket Bond #F-132522, under which Bond you undertake to indemnify the Phœnix National Bank and Trust Company, of Lexington, Ky., for,—

"any loss for the payment, whether received over the counter or through the clearing house or by mail, of forged or raised checks or (genuine) checks bearing forged endorsements or the establishment of any credit to any customer on the faith of such checks."

[fol. 19] We herewith inclose you the said itemized Proof of Claim, duly sworn to. Please let us have your check for the sum of $5512.72, with interest from this date, and oblige,

Very truly yours, Phœnix National Bank and Trust Company, of Lexington, by W. H. Courtney, President."

That the Proof or Claim, duly sworn to and referred to in that letter, was inclosed with said letter, and a copy thereof is herewith filed, referred to and made part hereof, marked Exhibit "Proof of Claim"; that the said defendant received said letter, bearing date January 14, 1926, to-

gether with the Proof of Claim thereto attached, on the 19th of January, 1926; that notwithstanding the plaintiff did in said letter of January 14, 1926, demand of defendant the sum of $5,512.72, with interest from said date, and on said date did advise, represent, state and inform the defendant that plaintiff had paid said claims hereinbefore set out, in full to the Petroleum Company, by crediting its account with the said amount—that notwithstanding said facts, the defendant has failed and refused to pay same, and still fails and refuses to pay plaintiff the said amount, or any part thereof.

Wherefore the plaintiff prays judgment against the defendant for the sum of Five Thousand Five Hundred and Twelve Dollars and seventy-two cents ($5,512.72), with interest from January 14, 1926, for its costs herein expended and for all proper relief.

B. D. Berry, Attorney for Plaintiff.

Duly sworn to by W. H. Courtney. Jurat omitted in printing.

[fol. 20] Endorsement: Petition and copy and one (1) exhibit filed, summons and Copy to Franklin County and Summons and copy to Fayette County issued. February 3rd, 1926. Att.: J. H. Carter, C. F. C. C.

EXHIBIT TO PETITION

STATE OF KENTUCKY,
County of Fayette:

W. H. Courtney says that he is President of the Phœnix National Bank and Trust Company, of Lexington, Kentucky; that said bank is the owner of the claim hereto attached against the Ætna Casualty and Surety Company, amounting to the sum of Fifty-five Hundred and Twelve Dollars and seventy-two cents ($5,512.72), with interest from this date.

That the basis of and consideration for said claim, is certain forged checks and raised checks, the forging and raising of which was executed by H. D. Fulton, on account of the Petroleum Company, one of the depositors of the

said Phœnix National Bank and Trust Company; that the total list of said checks is as follows:

List of Checks of the Petroleum Company altered or containing forged endorsements, or both, paid and charged to it by the Phœnix National Bank and Trust Company

(Note.)—"r" indicates check raised; "f" indicates forged endorsement.

Number	Payee	Amount			Benefit to company
1272	Floyd B. Fitch	$176.90	r.	f.	
1277	F. B. Fitch	317.90	r.	f.	
1296	Floyd Shellito	100.00		f.	
1297	Homer Thrawley	108.00		f.	
[fol. 21]					
1421	Felix M. Miles	482.80		f.	
1445	H. Thrawley	117.00		f.	
1486	Robert Day	125.00	r.	f.	
1501	Felix M. Miles	88.96	r.	f.	
1515	Floyd B. Fitch	81.88	r.	f.	
1563	H. O. Randel	34.00		f.	
1655	Floyd Shellito	100.00		f.	
1656	Homer Thrawley	117.00		f.	
1659	John B. Miles	159.97	r.	f.	
1660	Floyd B. Fitch	170.00	r.	f.	
1662	Whitley Isaacs	10.00		f.	
1664	Floyd B. Fitch	200.00		f.	
1665	L. F. Feely	250.00		f.	
1681	Carl Burgess	45.00		f.	
1682	Clifford Couch	45.00		f.	
1685	John Hale	105.00		f.	
1705	Floyd Shellito	111.25	r.	f.	
1746	Floyd B. Fitch	134.02	r.	f.	
1747	Hugh E. Williamson	139.37	r.	f.	
1748	Floyd B. Fitch	115.75	r.	f.	
1845	Sam Hackworth	77.50	r.	f.	
1846	The Model Oil Company	115.00	r.	f.	
1847	Homer Thrawley	114.92		f.	
1848	Robert Day	146.00	r.	f.	
1849	Henry Day	30.00		f.	
1850	Ova Day	66.00	r.	f.	

Number	Payee	Amount		Benefit to company
1854	Cash	150.00	r.	$1.50
1855	G. Arthur Bush	225.00	r. f.	.....
1856	J. D. Ruse	90.00	f.	.....
1882	H. D. Fulton	112.50	r.	12.50
1904	H. D. Fulton	72.50	r.	12.50
1915	H. D. Fulton	212.50	r.	12.50
1916	Frank Rice	112.50	f.	.....
1918	Glen Smith	314.00	r. f.	.....
1919	Homer Thrawley	379.00	r. f.	.....
	Total	$5,551.72		$39.50

[fol. 22] Schedule of checks paid by Phœnix National Bank and Trust Company, and improperly charged to account of the Petroleum Company by reason of the fact that either said check- were fraudulently altered and raised after being signed, or that they contain forged endorsements, or that they were both so altered and contain forged endorsements

Check No. 1272

Dated May 12-1924, payable to order of Floyd B. Fitch for $176.90. Endorsements—"Floyd B. Fitch" (pencil) forged—"H. D. Fulton" "La Fayette Hotel Co."—"Bank of Commerce, Lexington, Kentucky." Paid by bank June 17-1924.

In addition to containing the forged endorsement of the payee, said check was altered and raised from 90 cents to the amount indicated.

Check No. 1277

Dated June 21-1924, payable to order of Floyd B. Fitch for $317.90. Endorsements—"F. B. Fitch" (forged)—"H. D. Fulton" "La Fayette Hotel Co."—"Bank of Commerce, Lexington, Kentucky." Paid by bank June 24-1924.

In addition to containing the said forged endorsement, the check was fraudulently altered and raised from $17.90 to the amount indicated.

Check No. 1296

Dated June 15-1924, payable to order of Floyd Shellito for $100.00. Endorsements—"Floyd Shellito" (forged),

"H. D. Fulton" "La Fayette Hotel Co."—"Bank of Commerce, Lexington, Kentucky." Paid by bank August 5-1924.

Check No. 1297

Dated June 15-1924, payable to order of Homer Thrawley for $108.00. Endorsements "H. Thrawley" (pencil) forged—"H. D. Fulton" "La Fayette Hotel Co."—"Bank of Commerce, Lexington, Kentucky." Paid by bank June 28-1924.

[fol. 23] Check No. 1421

Dated September 27-1924, payable to order of Felix M. Miles for $482.80. Endorsements—"Felix M. Miles" (forged) "H. F. D." ("H. F. D.") Paid by bank October 4-1924.

Check No. 1445

Dated August 20-1924, payable to order of H. Thrawley for $117.00. Endorsements—"H. Thrawley" (forged)—"LaFayette Hotel Company"—"Bank of Commerce, Lexington, Ky." Paid by bank August 22-1924.

Check No. 1486

Dated August 25, 1924, payable to order of Robert Day for $125.00. Endorsements—"Robert Day" (pencil) forged—"H. D. Fulton" "LaFayette Hotel Co."—"Bank of Commerce, Lexington, Ky." Paid by bank August 27-1924.

In addition to containing the said endorsement-, the check was fraudulently altered and raised from $25.00 to the amount indicated.

Check No. 1501

Dated August 25-1924, payable to order to Felix M. Miles for $88.96. Endorsements—"Felix M. Miles" (forged)—"H. D. Fulton," "LaFayette Hotel Co."—"Bank of Commerce, Lexington, Ky." Paid by bank August 28-1924.

In addition to containing the said endorsement-, the check was fraudulently altered and raised from $8.56 to the amount indicated.

Check No. 1515

Dated August 29-1924, payable to order of Floyd B. Fitch for $81.88. Endorsements—"Floyd B. Fitch" (forged) "H. D. Fulton" "LaFayette Hotel Co."—"Bank of Commerce, Lexington, Kentucky." Paid by bank September 3-1924.

In addition to containing the said endorsement-, the check was fraudulently altered and raised from $1.88 to the amount indicated.

[fol. 24] Check No. 1563

Dated September 13-1924, payable to order of H. O. Randel for $34.00. Endorsements—"H. O. Randel" (forged) "H. D. Fulton" "LaFayette Hotel Company." Paid by bank September 18-1924.

Check No. 1655

Dated October 15-1924, payable to order of Floyd Shellito for $100.00. Endorsements—"Floyd Shellito" (forged) "LaFayette Hotel Co."—"Bank of Commerce, Lexington, Ky." Paid by bank October 24-1924.

Check No. 1656

Dated October 15-1924, payable to order of Homer Thrawley for $117.00. Endorsements—"Homer Thrawley" (forged)—"H. D. Fulton" "LaFayette Hotel Co."—-Bank of Commerce, Lexington, Ky." Paid by bank October 22-1924.

Check No. 1659

Dated October 29-1924, payable to order of John B. Miles for $159.97. Endorsements—"John B. Miles" (forged).

In addition to containing the said endorsement, the check was fraudulently altered and raised from $1.20 to the amount indicated. Paid by bank November 7-1924.

Check No. 1660

Dated October 29-1924, payable to order of Floyd B. Fitch for $170.00. Endorsement—"Floyd B. Fitch" (forged). Paid by Bank November 1-1924.

In addition to containing the said endorsements, the check was fraudulently altered and raised from $1.20, to the amount indicated.

Check No. 1662

Dated November 4-1924, payable to the order of Whitley Isaacs for $10.00. Endorsements—"Whitley Isaacs" (pencil) (forged)—"Blue Bird Taxi Co., Everett Glass." "Guaranty Bank & Trust Co. Lexington, Ky." Paid by Bank February 14-1925.

[fol. 25] Check No. 1664

Dated November 4-1924, payable to order of Floyd B. Fitch for $200.00. Endorsements—"Floyd B. Fitch" (forged)—"LaFayette Hotel Co."—"Bank of Commerce, Lexington, Ky." Paid by bank November 6-1924.

Check No. 1665

Dated November 3rd-1924, payable to order of L. F. Feely for $250.00. Endorsements—"L. F. Feely, (forged) —"H. D. Fulton"—"LaFayette Hotel Co."—"Bank of Commerce, Lexington, Ky." Paid by bank November 8-1924.

Check No. 1681

Dated November 12, 1924, payable to order of Carl Burgess for $45.00. Endorsements—"Carl Burgess" (pencil) forged—"H. D. Fulton"—"LaFayette Hotel Co."—Bank of Commerce, Lexington, Kentucky." Paid by bank November 15-1924.

Check No. 1682

Dated November 12-1924, payable to order of Clifford Couch for $45.00. Endorsements—"Clifford Couch" (pencil) forged—"H. D. Fulton" "LaFayette Hotel Co."—"Bank of Commerce, Lexington, Ky." Paid by bank November 14-1924.

Check No. 1685

Dated November 15-1924, payable to order of John Hale for $105.00. Endorsements—"John Hale" (pencil) forged

—"H. D. Fulton" "LaFayette Hotel Co."—"Bank of Commerce, Lexington, Ky." Paid by bank November 25-1924.

Check No. 1705

Dated November 25-1924, payable to order of Floyd Shellito for $111.25. Endorsements—"Floyd Shellito" (forged)—"H. D. Fulton" "LaFayette Hotel Co." -Bank of Commerce, Lexington, Ky." Paid by bank December 4 1924.

In addition to containing the said endorsements, the check was fraudulently altered and raised from $1.25, to the amount indicated.

[fol. 26] Check No. 1746

Dated December 16-1924, payable to order of Floyd B. Fitch for $134.02. Endorsements—"Floyd B. Fitch" (forged) "LaFayette Hotel Co." -Bank of Commerce, Lexington, Ky." Paid by bank December 30-1924.

In addition to containing the said endorsement-, the check was fraudulently altered and raised from $34.02 to the amount indicated.

Check No. 1747

Dated February 16-1924, payable to order of Hugh E. Williamson for $139.37. Endorsements—"Hugh E. Williamson" (pencil) forged—"LaFayette Hotel Co."—-Bank of Commerce, Lexington, Ky." Paid by bank December 16, 1924.

In addition to containing the said endorsement-, the check was fraudulently altered and raised from $39.37 to the amount indicated.

Check No. 1748

Dated December 16-1924, payable to order of Floyd B. Fitch for $115.75. Endorsements—"Floyd B. Fitch" (forged)—"H. D. Fulton" "LaFayette Hotel Co."—-Bank of Commerce, Lexington, Ky." Paid by bank December 23-1924.

In addition to containing the said endorsement-, the check was fraudulently altered and raised from $15.75 to the amount indicated.

Check No. 1845

Dated April 15-1925, payable to order of Sam Hackworth for $77.50. Endorsements—"Sam Hackworth- (pencil) forged—"H. D. Fulton." Paid by bank May 28, 1925.

In addition to containing the said endorsement-, the check was fraudulently altered and raised from $7.50 to the amount indicated.

Check No. 1846

Dated April 15th, 1925, payable to order of The Model Oil Company for $115.00. Endorsements—"The Model Oil Company By: Henry Day," (forged)—"H. D. Fulton." Paid by bank May 26-1925.

In addition to containing the said endorsement-, the check [fol. 27] was fraudulently altered and raised from $15.00, to the amount indicated.

Check No. 1847

Dated April 15-1925, payable to order of Homer Thrawley for $114.92. Endorsements—"Homer Thrawley" (pencil) forged, "LaFayette Hotel Co."—-Bank of Commerce, Lexington, Kentucky." Paid by bank May 9-1925.

Check No. 1848

Dated April 15-1925, payable to order of Robert Day for $146.00. Endorsements—"Robert Day" forged—"H. R. Fulton—LaFayette Hotel Company" -Bank of Commerce, Lexington, Ky." Paid by Bank April 22-1925.

In addition to containing the said endorsement-, the check was fraudulently altered and raised from $6.00, to the amount indicated.

Check No. 1849

Dated April 15-1925, payable to order of Henry Day for $30.00. Endorsements—"Henry Day" (forged), "H. D. Fulton" -LaFayette Hotel Co." "Bank of Commerce, Lexington, Ky.- Paid by bank May 14-1925.

Check No. 1850

Dated April 15-1925, payable to order of Ova Day for $66.00. Endorsements—"Ova Day" (pencil) forged, "H.

D. Fulton''—LaFayette Hotel Company'' -Bank of Commerce, Lexington, Ky.'' Paid by bank May 20-1925.

In addition to containing the said endorsements, the check was fraudulently altered and raised from $6.00 to the amount indicated.

Check No. 1854

Dated April 20-1925, payable to order of Cash for $150.00. Endorsement—''H. D. Fulton'' ''LaFayette Hotel Co.'' -Bank of Commerce, Lexington, Kentucky.'' Paid by bank April 22-1925.

Said check was fraudulently altered and raised from $1.50 to the amount indicated.

[fol. 28] Check No. 1855

Dated April 22-1925, payable to order of G. Arthur Bush for $225.00. Endorsements—''G. Arthur Bush'' (pencil) forged, ''H. D. Fulton'' ''LaFayette Hotel Co.'' -Bank of Commerce, Lexington, Ky.'' Paid by bank April 28-1925.

In addition to containing the said endorsement-, the check was fraudulently altered and raised from $3.00 to the amount indicated.

Check No. 1856

Dated April 24-1925, payable to order of J. D. Ruse for $90.00. Endorsements—''J. D. Ruse'' (pencil) forged, ''H. D. Fulton'' ''LaFayette Hotel Co.'' -Bank of Commerce, Lexington, Ky.'' Paid by bank April 28, 1925.

Check No. 1882

Dated May 15-1925, payable to order of H. D. Fulton for $112.50. Endorsements—''H. D. Fulton'' ''LaFayette Hotel Co.'' ''Bank of Commerce, Lexington, Ky.'' Paid by bank May 18-1925.

Said check was fraudulently altered and raised from $12.50 to the amount indicated.

Check No. 1904

Dated June 8-1925, payable to order of H. D. Fulton for $72.50. Endorsements ''H. D. Fulton'' ''LaFayette Hotel

Co." "Bank of Commerce, Lexington, Ky." Paid by bank June 10-1925.

Said check was fraudulently altered and raised from $12.50 to the amount indicated.

Check No. 1915

June 22-1925, payable to order of H. D. Fulton for $212.50. Endorsement—"H. D. Fulton." Paid by bank June 23-1925.

Said check was fraudulently altered and raised from $12.50 to the amount indicated.

Check No. 1916

Dated July 28-1925, payable to order of Frank Rice for $112.00. Endorsements—"Frank Rice" (forged), "H. D. Fulton" LaFayette Hotel Co." "Bank of Commerce, Lex-
[fol. 29] ington, Kentucky." Paid by bank August 1, 1925.

Check No. 1918

Dated June 23-1925, payable to order of Glen Smith for $314.00. Endorsements—"Glen Smith" (pencil) forged, "H. D. Fulton." Paid by bank July 11-1925.

In addition to containing the said endorsement, the check was fraudulently altered and raised from $14.00 to the amount indicated.

Check No. 1919

Dated June 23-1925, payable to order of Homer Thrawley for $379.00. Endorsements—"Homer Thrawley" (pencil) forged, "Wm. A. Waples, Agent By (H)." Paid by bank July 8-1925.

In addition to the said endorsement, the check was fraudulently altered and raised from $179.00 to the amount indicated.

That the demand of the Petroleum Company on the Phœnix National Bank and Trust Company to credit its account for said amount of $5,512.72, is in words and figures as follows, viz.:

Lexington, Kentucky,
September 25-1925.

Phœnix National Bank and Trust Company, Lexington, Kentucky.

GENTLEMEN: We have recently discovered that a number of checks drawn on our account in your bank have been fraudulently altered and raised or contain forged endorsements of the payee, or others, so that they should not have been honored by you, and were improperly charged to our account.

We hand you herewith a list of such checks, with memorandum of facts indicating the invalidity in each case.

The aggregate amount of said checks so charged to our account is $5,551.72. As indicated by the list, our Company benefited by the checks to the extent of only $39.00, that being the amount for which certain raised checks were orig-[fol. 30] inally written, so that the net amount improperly charged to our account is $5,512.72, and you are hereby called upon to credit our account with such amount, or otherwise refund it.

As we have heretofore advised you, these matters were not discovered by us until after the absconding of H. D. Fulton, who seems to be responsible for all such irregularities, and who was the keeper of the accounts and checks and other records of the Company, and was thus enabled to conceal the existence of such irregularities from the officers of the Company.

We tender herewith the original checks so referred to, and offer to make such reasonable proof of the irregularities as may be desired, and to afford full opportunity and access to the books and records of the Company, for full investigation of such matters.

Respectfully, The Petroleum Company, by Felix M. Miles, President."

That in accordance with said demand of the Petroleum Company the Phœnix National Bank and Trust Company has this day credited the account of the Petroleum Company with the sum of $5,512.72, the repayment of which amount is now demanded by said bank against the Ætna

Casualty and Surety Company, under its Bankers' Blanket Bond F-132522, which bond is now in full force and effect.

W. H. Courtney.

Subscribed and sworn to before me by W. H. Courtney this the 14th day of January, 1926. My commission expires 31 day of October, 1928. Margaret O. Stone, Notary Public, Fayette County, Ky.

[fol. 31] In Circuit Court of Fayette County

Summons to Franklin County and Return on Same

Summons Ordinary

The Commonwealth of Kentucky:

Fayette Circuit Court

To the Sheriff of Franklin County, Greetings:

You are hereby commanded to summon The Ætna Casualty and Surety Company, a Corporation, to answer a petition filed against it in the Fayette Circuit Court by Phœnix National Bank and Trust Company of Lexington, a Corporation, and warn it that upon its failure to answer for thirty days after service hereof the petition will be taken for confessed, or it will be proceeded against, for contempt, and you will make due return of this summons as provided by law.

Witness J. H. Carter, Clerk of said Court, this 3rd day of February, 1926.

J. H. Carter, C. F. C. C. B. D. Berry, P. Q.

Sheriff's Return on Summons to Franklin County

Executed on the within named Insurance Co. by delivering to S. M. Saufley Insurance Commissioner for the State of Kentucky a true copy hereof. This Feb. 4, 1926.

Ambrose McDonald, S. F. C., by L. D. Rich, D. S.

IN CIRCUIT COURT OF FAYETTE COUNTY

SUMMONS TO FAYETTE COUNTY AND RETURN ON SAME

Summons Ordinary

THE COMMONWEALTH OF KENTUCKY:

FAYETTE CIRCUIT COURT

To the Sheriff of Fayette County, Greetings:

You are hereby commanded to summon The Ætna Casualty & Surety Company, a Corporation, to answer a petition filed against it in the Fayette Circuit Court by Phœnix National Bank and Trust Company of Lexington, a Corporation, and warn it that upon its failure to answer [fol. 32] for twenty days after service hereof the petition will be taken for confessed, or it will be proceeded against, for contempt, and you will make due return of this summons as provided by law.

Witness J. H. Carter, Clerk of said Court, this 3rd day of February, 1926.

J. H. Carter, C. F. C. C. B. D. Berry, P. Q.

Sheriff's Return on Summons to Fayette County

Executed Feb. 3, 1926, by delivering to The Ætna Casualty & Surety Co. a corporation, Sam Walton a true copy of the within summons.

E. H. Fuller, S. F. C. W. R. Milward III, D. S.

[fol. 33] IN CIRCUIT COURT OF FAYETTE COUNTY

[Title omitted]

ORDER OF REMOVAL TO FEDERAL COURT—February 23, 1926

This day came the defendant, The Ætna Casualty and Surety Company, by counsel, and filed its petition for removal of this cause to the United States District Court for the Eastern District of Kentucky, held at Lexington in said District, and filed its bond conditioned upon (1) its entering in said District Court, within thirty (30) days

after this date a certified copy of the record in this suit, and (2) its paying all costs that may be awarded by the said District Court if said District Court shall hold that this suit was wrongfully or improperly removed thereto; and said defendant also filed at the same time a written acceptance by the plaintiff, dated the 20th day of February, 1926, of service of notice of said petition and bond; whereupon it is ordered by this Court that the filing of said petition and bond and notice be, and it hereby is, noted of record, and that the said petition and bond be, and they hereby are, accepted, and this cause be, and it hereby is, removed to the District Court of the United States for the Eastern District of Kentucky, held at Lexington in said District.

[fol. 34] In Circuit Court of Fayette County

[Title omitted]

Notice—Filed February 23, 1926

To Phœnix National Bank and Trust Company of Lexington, the above-named plaintiff, and B. D. Berry, Its Attorney:

Notice is hereby given that on Tuseday the 23rd day of February, 1926, at or about the hour of 9:00 o'clock in the morning, the defendant in the above-entitled cause, The Ætna Casualty and Surety Company, will file in the above-named Court its petition and bond for the removal of the said cause from said court to the District Court of the United States in and for the Eastern District of Kentucky.

Wilson & Harbison, Counsel for Defendant.

The plaintiff in the above-styled action, Phœnix National Bank and Trust Company of Lexington, hereby accepts service of the foregoing notice, and acknowledges receipt of copies of the petition and bond therein mentioned, this 20th day of February, 1926.

Phœnix National Bank and Trust Company of Lexington, by B. D. Berry, Its Attorney.

[File endorsement omitted.]

[fol. 35] IN CIRCUIT COURT OF FAYETTE COUNTY

[Title omitted]

PETITION FOR REMOVAL TO THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF KENTUCKY—Filed February 23, 1926

Now comes The Ætna Casualty and Surety Company, the defendant in the above-entitled cause, and files this its petition for removal of this suit from this Honorable Court in which it is now pending to the District Court of the United States in and for the Eastern District of Kentucky, held at the City of Lexington in said District; and your petitioner respectfully shows:

That this cause was filed in this Court on the 3rd day of February, 1926, and that the time to plead, answer, or demur to the same has not expired under the laws of this State in such cases made and provided;

That this suit is brought by the plaintiff to recover of the defendant the sum of $5,512.72 alleged to be due under a bond, and is one of a civil nature, at law, of which the District Courts of the United States are given jurisdiction under the provisions of Section 24 of the Federal Judicial Code;

That the matter and amount in dispute in said suit exceeds, exclusive of interest and costs, the sum or value of $3,000.00;

That the defendant, The Ætna Casualty and Surety Company, in said suit was, at the time of the commencement of said suit, and continuously thereafter has been and now is, a non-resident of the State of Kentucky and was then, and still is, a corporation duly formed, created and existing under and by virtue of the laws of the State of Connecticut, and a citizen and resident of said State of Connecticut, having its principal place of business in the City of Hartford in the said state; and that the Phœnix National Bank and Trust Company of Lexington, the plaintiff in said suit, was at the time of the commencement thereof, and still is, a corporation duly organized and existing under [fol. 36] and by virtue of the national banking laws of the United States of America, and having its principal place

of business in the City of Lexington, in the State of Kentucky, and was then, and still is, a citizen and resident of the said State of Kentucky.

Your petitioner herewith files a good and sufficient bond under the statute in such case made and provided, conditioned as the law directs, and that it will within thirty (30) days from the filing of this petition for removal, file a certified copy of the record of this case in the District Court of the United States for the Eastern District of Kentucky, held at Lexington, in the said District, and for the payment of all costs which may be awarded by said Court if the said District Court shall determine that this suit was improperly or wrongfully removed thereto.

Your petitioner therefore prays this court that it proceed no further herein except to accept this petition and the said bond, and to order the removal prayed for, and to direct a transcript of the record in this action to be made and certified as provided by law.

Wilson & Harbison, Attorneys for said Defendant.

The affiant, Samuel B. Walton, being duly sworn, deposes and says that he is the chief agent in Fayette County, Kentucky, of the defendant, The Ætna Casualty and Surety Company and the same person upon whom the summons in this action was served, and that there is no officer of the said defendant in said county; and that the allegations of the foregoing petition for removal are true of his own, knowledge.

Sam. B. Walton.

Subscribed and sworn to before me by Samuel B. Walton this 23 day of February, 1926. J. H. Carter, C. F. C. C., by Katherine Laden, D. C.

[File endorsement omitted.]

[fol. 37] In Circuit Court of Fayette County

[Title omitted]

Bond for Removal—February 23, 1926

Know all men by these presents:

That we, The Ætna Casualty and Surety Company, as Principal, and Sam'l B. Walton, of Lexington, Ky., as Surety, are held and firmly bound unto the Phœnix Na-

tional Bank and Trust Company, of Lexington, Kentucky, the plaintiff in this cause, its successors and assigns, in the sum of Five Hundred Dollars ($500.00) for the payment of which well and truly to be made, we and each of us bind ourselves, our successors, heirs, executors and administrators, jointly and severally by these presents.

This obligation is upon condition, nevertheless, that whereas The Ætna Casualty and Surety Company has filed its petition in the Fayette Circuit Court of the State of Kentucky for the removal of the action therein pending wherein the Phœnix National Bank and Trust Company of Lexington, is plaintiff, and the said The Ætna Casualty and Surety Company is defendant, to the District Court of the United States for the Eastern District of Kentucky, sitting in the City of Lexington, in said District; now therefore, if the said The Ætna Casualty and Surety Company shall enter in the said District Court of the United States for the District aforesaid within thirty (30) days from the date of filing the said petition for removal, a certified copy of the record in said suit, and shall well and truly pay all costs that may be awarded by said District Court of the United States if said court shall hold that said suit was wrongfully or improperly removed thereto, then this obligation shall be void; otherwise it shall remain in full force and effect.

In Witness Whereof, we the said Principal and Surety have hereunto caused our names to be subscribed this 23 day of February, 1926.

[fol. 38] The Ætna Casualty and Surety Co., by Clinton M. Harbison, Attorney-in-fact. Sam'l B. Walton. (Seal.)

Approved and accepted.

Richard C. Stoll, Judge.

[File endorsement omitted.]

Clerk's certificate to foregoing transcript omitted in printing.

[fol. 39] Judge's certificate to clerk omitted in printing.

Clerk's certificate to judge omitted in printing.

[fol. 40] In United States District Court, Eastern District of Kentucky

Order Filing Transcript—Filed March 16, 1926

This day came the defendant and offered for filing a transcript of the proceedings had herein in the Fayette Circuit Court, and the court being advised, it is now ordered that said transcript be and the same is filed and placed on the law docket of this court.

A. M. J. Cochran, Judge.

In United States District Court

Motion for Rule to Require Plaintiff to File Bond—Filed April 15, 1926

The defendant, The Ætna Casualty and Surety Company, moves the court for a rule to require the plaintiff to file herein, in conformity with the provisions of Section 120 of the Civil Code of Practice of Kentucky, the bond upon which this action is founded.

Wilson & Harbison, Counsel for Defendant.

See Section 120, Civil Code of Practice of Kentucky, and Preston vs. Roberts, 12 Bush (Ky.) 570, and Thompson vs. Sunrise Coal Company's Trustee, 181 Ky. 158, 204 S. W. 89.

[fol. 41] In United States District Court

General Demurrer to Petition—Filed April 15, 1926

Without waiving its motion for a rule to require the filing of the bond, the defendant, The Ætna Casualty and

Surety Company, demurs generally to the petition herein for the reason that the same does not state facts sufficient to constitute a cause of action against it.

Wilson & Harbison, Counsel for Defendant.

The petition does not show that the plaintiff sustained a loss: it does not show that the plaintiff was legally compellable to repay the depositor or to re-credit its account, but did so voluntarily. The depositor's negligence in the drawing and issuance of the cheques, and also its failure to discover or report the fraud for such a long time, prevented it from having a valid claim against the plaintiff bank:

Bank vs. Morgan, 117 U. S. 96; 29 Law Ed. 811;
First National Bank of Evansville vs. Fourth National Bank of Louisville, 56 Fed. 967;
Hennesy vs. Memphis National Bank, 129 Fed. 557;
Stallo vs. Wagner, 220 Fed. 360;
England National Bank vs. United States, 282 Fed. 121;
General Cigar Company vs. First National Bank of Portland, 290 Fed. 143;
Hackett vs. First National Bank, 114 Ky. 193; 70 S. W. 664.

[fol. 42] In United States District Court

Order Noting Filing of Motion and Demurrer—Filed Apr. 15, 1926

The defendant, The Ætna Casualty and Surety Company, files herein its motion, under Section 120 of the Civil Code of Practice of Kentucky, for a rule to require the plaintiff to file in this action the bond upon which the action is founded; and the said defendant, without waiving its said motion, files also its general demurrer to the petition herein; and it files also a brief statement of the grounds for the said motion and the said general demurrer.

A. M. J. Cochran, Judge.

IN UNITED STATES DISTRICT COURT

NOTICE—Filed May 11, 1926

To Messrs. Wilson & Harbison, attorneys for defendant:

Please take notice that on May 1, 1926, or prior thereto, I will apply to the Clerk of this Court to have the above cause noted for trial at the June Term thereof, 1926.

B. D. Berry, Attorney for Plaintiff.

The service of the above notice is hereby acknowledged, this 23rd day of April, 1926—without, however, any consent on the part of the undersigned or their client Ætna Casualty & Surety Co., to a trial, as the issues of this case are not yet joined.

Wilson & Harbison, Attorneys for Defendant.

[fol. 43] IN UNITED STATES DISTRICT COURT

ORDER ASSIGNING CAUSE—Filed May 11, 1926

This day came the plaintiff, and upon its motion, the court being advised, it is ordered that this cause be and the same is now set for the first day of the June Term, 1926, of this court, to-wit: June 14, 1926; on that day to be assigned by the court for trial on a day certain of said Term.

A. M. J. Cochran, Judge.

May 11, 1926.

IN UNITED STATES DISTRICT COURT

ORDER OVERRULING DEMURRER—Filed 6/22/26

The defendant's demurrer to the plaintiff's petition having been considered by the Court and the Court being sufficiently advised, it is ordered and adjudged that the said demurrer be overruled, to which the defendant excepts.

This order is to be entered.

B. D. Berry, Attorney for Plaintiff. Wilson & Harbison, Attorneys for Defendant.

Enter. A. M. J. Cochran, Judge.

[fol. 44] IN UNITED STATES DISTRICT COURT

ORDER FILING AMENDED PETITION—Filed 6/23/26

Came this day the plaintiff herein and filed its Amended Petition herein.

This order is to be entered.

B. D. Berry, Attorney for Plaintiff. Wilson & Harbison, Attorneys for Defendant.

Enter. A. M. J. Cochran, Judge.

IN UNITED STATES DISTRICT COURT

AMENDED PETITION

The plaintiff, by leave of Court herein, comes and amends its petition, and says that each, all and every one of the checks, paid out by it as set out in its original petition herein, were checks that were issued by the said Petroleum Company on this plaintiff, and that said checks, and each of them, on presentment were paid by this plaintiff in the regular course of its business and in good faith, and without any notice that said cheeks, or any of them or any endorsement thereon, were forged or had been raised in amount.

Plaintiff further says that the said H. D. Fulton, named in its original petition, who fraudulently altered and raised said checks and committed forgery, in said petition set out, did so without any authority for so doing and without any knowledge on the part of this plaintiff that same had been done.

Wherefore the plaintiff prays as in its original petition, for costs and all proper relief.

B. D. Berry, Attorney for Plaintiff.

[fol. 45] *Duly sworn to by W. H. Courtney. Jurat omitted in printing.*

IN UNITED STATES DISTRICT COURT

AMENDED AND SUBSTITUTED ANSWER—Filed May 6, 1927

The defendant, The Ætna Casualty and Surety Company, comes now and files this its Amended Answer to the Petition and Amended Petition, praying that same be

taken in substitution for its original Answer herein, and states as follows:

The defendant denies that the plaintiff did suffer loss as stated in the Petition, or at all, through payment of cheques as stated in the Petition, or through payment of any cheque or cheques.

The defendant denies that said H. D. Fulton forged the name of Felix M. Miles on the back of Cheque #1421 of The Petroleum Company, described in the Petition and filed therewith as Exhibit #22; but this defendant states that the signature of said Felix M. Miles' name on the back of said cheque never purported to have been made by said Felix M. Miles himself, but that said signature was followed, underneath, by the signed initials, "H. D. F.", and purported all the while to have been made by said H. D. Fulton; and that said Felix M. Miles was at all times mentioned in the Petition, and is now, the President of the said The Petroleum Company, and known [fol. 46] by the plaintiff so to be, and the said H. D. Fulton was its bookkeeper, and known by the plaintiff so to be.

The defendant denies that check #1854 of The Petroleum Company, described in the Petition and filed therewith as Exhibit 39, was ever issued by said Petroleum Company in the sum of $1.50, or that thereafter H. D. Fulton or any other person ever altered or raised said cheque or increased the amount provided to be paid thereon; but this defendant states that said cheque was originally drawn and issued in the sum of $150.00,—the sum which the plaintiff paid thereon as set forth in the Petition; and this defendant states that said cheque was originally drawn and issued payable to "Cash" and marked "For J. Fred Miles"; and that said J. Fred Miles, who himself signed said cheque on behalf of the drawer, was at all times mentioned in the Petition, and is now, authorized to sign and issue cheques on behalf of said The Petroleum Company, and was, and was known by the plaintiff to be, the person who actively controlled and directed the operation of the said Company's business and affairs.

This defendant further states that John B. Miles, whose endorsement as payee was forged on cheque #1659 described in the Petition and filed as Exhibit #4 therewith, is the brother of said Felix M. Miles and J. Fred Miles, and was formerly Vice-President and Treasurer of said The Petroleum Company; and that Floyd B. Fitch, whose en-

dorsement as payee was forged on cheques #'s 1272, 1277, 1515, 1660, 1664, 1746 and 1748 described in the Petition and filed therewith as Exhibits #'s 1, 20, 3, 5, 30, 8 and 10, respectively, was at the times of issuance of said cheques and of their payment by the plaintiff Bank and return to said Petroleum Company the Secretary of said Company.

This defendant further states that the said The Petroleum Company's cheque-book stubs of cheques #'s 1644, 1665 and 1856 mentioned in the Petition and filed therewith as Exhibits #'s 30, 31 and 37, respectively, were plainly marked across their face "Void," when said cheques were issued, and that they continue to be so marked to this date; and that each of said three cheques was drawn and issued payable to a person to whom the said The Petroleum Company was not indebted at the time.

The defendant denies that the plaintiff either advised it or stated to it that the said cheques, or that any of same, had been forged or raised or were not genuine as soon as [fol. 47] possible after plaintiff learned of said alleged loss, or as soon as possible after the 25th day of September, 1925, or within a reasonably prompt time after the plaintiff learned of the claim of its said depositor, The Petroleum Company, on account of the said cheques; but the defendant states that the plaintiff wholly failed to give this defendant any notice whatever of any irregularity or fraud or loss in connection with any of said cheques until the 2nd day of October, 1925, when it wrote its letter of that date which is copied into the Petition.

This defendant denies that on or about November 25, 1925, or at any time, it denied all liability to the plaintiff upon or in connection with the aforesaid claim of the plaintiff's said depositor; but it states that it stated to the plaintiff, immediately upon receiving notice of said claim, that the plaintiff Bank itself was excused from all liability to its said depositor in respect of said cheques, on account of the negligence of said depositor, as hereinabove specified, and on account of said depositor's delay in giving the plaintiff notice of the frauds committed as recited in the Petition; and this defendant states that at the same time it demanded of the plaintiff as its obligee under the bond herein sued upon, that the plaintiff should not admit any liability, or make any payment, upon said claim until it should be judicially determined that the plaintiff was liable thereon; and

this defendant further states that it assured the plaintiff at that time that it, the defendant, would undertake the defense of any suit to be brought by said depositor upon said claim and bear all expense in connection therewith. And at the same time this defendant demanded of the plaintiff that it make immediate demand upon all prior endorsers of any of said cheques to take up the same by virtue of their endorsements, but that this the plaintiff refused to do.

The defendant further states that nevertheless in spite of this defendant's said demand that the plaintiff made no admission of liability upon the said claim of its said depositor, the plaintiff on or about the 14th of January, 1926, without the knowledge or consent of this defendant, entered a credit of the sum of $5512.72 back to the account of said depositor; but this defendant states that it has not knowledge or information sufficient to form a belief, and therefore it denies that the said credit to the said depositor's account was in whole or in part an absolute or unconditional credit, or that it amounted to a final repayment to said de-
[fol. 48] positor of any amount theretofore charged against it by the plaintiff on account of said cheques or any of them.

Paragraph II

For further answer to the Petition and Amended Petition herein the defendant, The Aetna Casualty and Surety Company, re-affirming and making part hereof all the allegations in Paragraph I of this Answer, states:

That from a time prior to the 12th day of May, 1924, the date on which the first of the cheques mentioned in the Petition was issued, until after the 28th day of July, 1925, when the last dated of said cheques was issued, the aforesaid H. D. Fulton was the trusted employee and clerk of the plaintiff's depositor aforesaid, The Petroleum Company; and that throughout said time said Fulton was charged by the said depositor with the duty of preparing its cheques for signature by its officers and sending or delivering said cheques to their several payees; and said Fulton during the whole of said time kept the books of account and financial records of the said depositor, and made all the entries in its said books of account, and made its bank deposits with the plaintiff Bank, and obtained from the plaintiff Bank the monthly statements of the bank account together with the cancelled cheques or vouchers. And

no officer of the said depositor made any examination of the said depositor's said books of account, cheque books, bank statements or cancelled vouchers with a view to ascertaining the correctness thereof; but the keeping of all said books and statements and records was negligently committed entirely to the said Fulton; and he alone prepared all the cheques of the said depositor for signature by its officers; and it was the negligent habit of the said officers to sign and to issue without question any cheque presented by said Fulton for signature, without ascertaining whether the amount of such cheque was due to the payee thereof or not.

That each of the cheques alleged in the Petition to have been altered and 'raised' was negligently drawn and issued by the plaintiff's depositor, the Petroleum Company, in such a way as to facilitate the alteration or 'raising' on its face of the sum of money ordered thereby to be paid; that blank spaces were negligently left by the drawer aforesaid on the face of each of said cheques in both the two places for the designation of the sum of money to be made payable, in such a way as to render it easy to write additional words [fol. 49] and figures in said spaces and thereby increase the sum of money made payable by the cheque, without giving it the appearance of having been altered.

That during each month throughout the time from the 12th of May, 1924, to the 1st of August, 1925, the plaintiff's said depositor, the Petroleum Company, was furnished by the plaintiff with the customary monthly statement of its bank account, showing in detail the deposits made and the cheques paid and charged to the said depositor's account, and the balances to the credit of said account at the beginning and the end of the month; and with each such monthly statement the cheques listed therein as having been paid by the plaintiff and charged to the said depositor's account were themselves returned, cancelled, to the said Petroleum Company; but that at no time during said period was any examination of any of said statements of account or cancelled cheques made by any officer of the said depositor, the Petroleum Company, or by anyone upon behalf of said depositor except the said H. D. Fulton himself.

And the defendant states that but for the above stated negligence of the said depositor, in its failure to supervise or check up or examine its books and records as kept by its said employee Fulton, and its failure to use ordinary

care in the drawing and issuing of its cheques in such a form as not to facilitate their being raised, and its failure to examine or inspect its monthly bank statements of account and returned cancelled cheques, the frauds complained of in the Petition would not have occurred, and the payments of the cheques mentioned in the Petition would not have been made by the plaintiff; and by reason of said negligence on the part of the plaintiff's said depositor, the plaintiff had a good defense against any claim of said depositor to compel repayment or recrediting of the amount paid by plaintiff on any or all of said cheques; and if the plaintiff did in fact pay the claim of said depositor in the sum of Fifty-Five Hundred Twelve Dollars and Seventy-Two Cents ($5512.72) as alleged in the Petition, or in any sum, or did in fact recredit the said depositor's account in the said sum or in any sum, on account of the plaintiff's payment of the said cheques or any of them, the plaintiff repaid or recredited the said account voluntarily and without being obligated or lawfully compellable so to do.

[fol. 50] Paragraph III

For further answer to the Petition and Amended Petition herein, the defendant, The Aetna Casualty and Surety Company, reaffirming and making part hereof all and singular the averments of the first and second paragraphs of this Answer, states further as follows:

Although the above-mentioned monthly bank statements, with the accompanying cancelled cheques, were returned by the plaintiff to its depositor, the Petroleum Company, each month during the period from the 1st of June, 1924, to and including the 1st of August, 1925, as set forth in the second paragraph of this Answer, the said depositor never objected or took any exception to any of the aforesaid monthly statements of its account with the plaintiff until after the payment by the plaintiff on the 1st day of August, 1925, of the last of the cheques mentioned in the Petition; and furthermore, the said depositor did not even then notify the plaintiff of any irregularity in respect of any of the said cheques or make any demand upon plaintiff for repayment of any amount charged against its account by the plaintiff on account of any of said cheques, until the 25th day of September, 1925. And meanwhile on or about the 1st day of August, 1925, the above named H. D. Fulton had left the

City of Lexington for parts unknown; and neither the plaintiff nor the defendant nor the said Petroleum Company has thereafter at any time been able to ascertain where he was, or to learn of any property or assets which might be subjected to any claim or judgment against him.

Thirty-one (31) of the cheques described in the Petition were paid by the plaintiff, as appears from the Petition, to other banks of the City of Lexington; and each of said thirty-one cheques prior to its payment by the plaintiff bore the endorsement of the bank which presented it to the plaintiff for payment; twenty-nine (29) of said thirty-one cheques bore the endorsement of the Bank of Commerce of Lexington, Kentucky, and the total sum of money paid by the plaintiff to the said Bank of Commerce upon said twenty-nine cheques was Thirty-Six Hundred Six Dollars and Ninety-five Cents ($3606.95); and the other two (2) of said thirty-one cheques bore the endorsement of the Guaranty Bank & Trust Company, of Lexington, Kentucky, and the total sum of money paid by the plaintiff to said Guaranty Bank & Trust Company on account of said two cheques was Forty-Four Dollars ($44.00); and thirty (30) of the said [fol. 51] thirty-one cheques bore also the prior endorsement of the Lafayette Hotel Company, of Lexington, Kentucky; and both the said two presenting banks and the said Lafayette Hotel Company are, and were at all times mentioned in the Petition, solvent corporations of the State of Kentucky, abundantly able to pay the amounts of all of said cheques. Yet the plaintiff has never made any demand upon any of said prior endorsers of any of said cheques upon their endorsements thereon; although this defendant immediately upon learning of the alleged frauds in the negotiations of said cheques demanded of the plaintiff that it make such a demand upon each of said prior endorsers on said cheques. And meantime the several accounts between the plaintiff bank and the two said prior endorser banks had regularly been stated and settled every banking day upon the basis that the said cheques were proper and bona fide cheques and properly and validly endorsed and paid.

Wherefore, the defendant prays that the plaintiff take nothing by its Petition, but that it be adjudged herein that the plaintiff sustained no loss within the contemplation of the bond herein sued upon; that the plaintiff's voluntary recrediting of its depositor's account before the

loss had been established or sustained, and over the objection of the defendant, the indemnitor in the bond, forfeited all right on the plaintiff's part to call upon the defendant for indemnity as for a loss sustained under the bond; and that even if the plaintiff had not thus forfeited all right in the premises, it could never have shown a loss sustained, because the account as between plaintiff and its depositor had long since been stated and settled under such circumstances of negligence on the part of the depositor as to disentitle it to any right of action to compel the opening up and falsifying and crediting of said accounts; and the defendant prays for all proper relief.

Wilson & Harbison, Counsel for Defendant.

[fol. 52] In United States District Court

General Demurrer—Filed May 6, 1927

The plaintiff comes and demurs generally to the defendant's Amended and Substituted answer herein, and especially to the second and third paragraphs thereof, because the facts stated in said second and third paragraphs, or in neither of them, are sufficient to constitute a defense to this action.

B. D. Berry, Attorney for Plaintiff.

In United States District Court

Motion to Strike Out—Filed May 6, 1927

The plaintiff comes and moves the Court to strike out that part of the Amended and Substituted Answer of defendant, filed herein, beginning with the word "and", on the third line from the bottom of the first page thereon, and ending with the word, "be", on the second line of the second page, the part to be stricken out being in words and figures as follows, viz:

"and that said Felix M. Miles was at all times mentioned in the Petition, and is now, the President of The Petroleum Company, and known by the plaintiff so to be, and

the said H. D. Fulton was its bookkeeper, and known by the plaintiff so to be."

The plaintiff comes and moves the Court to strike out of the Amended and Substituted Answer all that part beginning with the word, "but" on the 8th line of the second page, and ending with the word, "affairs" on the 19th line of the same page, the part to be stricken out being in words and figures, as follows, viz:

[fol. 53] "but this defendant states that said cheque was originally drawn and issued in the sum of $150.00—the sum which the plaintiff paid thereon as set forth in the Petition; and this defendant states that said cheque was originally drawn and issued payable to "Cash" and marked "For J. Fred Miles"; and that said J. Fred Miles, who himself signed said cheque on behalf of the drawer, was at all times mentioned in the petition, and is now, authorized to sign and issue cheques on behalf of said The Petroleum Company, and was, and was known by the plaintiff to be, the person who actively controlled and directed the operation of the said Company's business and affairs."

The plaintiff comes and moves the Court to strike out of the Amended and Substituted Answer all that part beginning with the word, "This" in line 20, of the second page, and ending with the word, "time" in line 8, of the third page; the part to be stricken out being in words and figures as follows, viz:

"This defendant further states that John B. Miles, whose endorsement as payee was forged on check #1659 described in the Petition and filed as Exhibit #4 therewith, is the brother of said Felix M. Miles and J. Fred Miles, and was formerly Vice-President and Treasurer of The Petroleum Company; and that Floyd B. Fitch, whose endorsement as payee was forged on cheques #'s 1272, 1277, 1515, 1660, 1664, 1746 and 1748 described in the Petition and filed therewith as Exhibits #'s 1, 20, 3, 5, 30, 8, and 10, respectively, was at the times of issuance of said cheques and of their payment by the plaintiff Bank and return to said Petroleum Company the Secretary of said Company."

"This defendant further states that the said The Petroleum Company's cheque-book stubs of cheques #'s 1664, 1665 and 1856 mentioned in the Petition and filed therewith as Exhibits #'s 30, 31 and 37, respectively, were plainly marked across their face "Void", when said cheques were issued, and that they continue to be so marked to this date; and that each of said three cheques was drawn and issued payable to a person to whom the said The Petroleum Company was not indebted at the time."

[fol. 54] The plaintiff comes and moves the Court to strike out of the Amended and Substituted Answer all that part, beginning with the word, "but" on the 16th line of page 3, and ending with the word, "Petition" on the same page in line 21; the part to be stricken out being in words and figures as follows, viz:

"but the defendant states that the plaintiff wholly failed to give this defendant any notice whatever of any irregularity or fraud or loss in connection with any of said cheques until the 2nd day of October, 1925, when it wrote its letter of that date which is copied into the Petition."

The plaintiff comes and moves the Court to strike out of the Amended and Substituted Answer of defendant, all that part beginning with the word, "but", in line 25, of the 3rd page, and ending with the word, "them", being the last word of the first paragraph, on page 3-2; the part to be stricken out being in words and figures as follows, viz:

"but it states that it stated to the plaintiff, immediately upon receiving notice of said claim, that the plaintiff Bank itself was excused from all liability to its said depositor in respect of said cheques, on account of the negligence of said depositor, as hereinabove specified, and on account of said depositor's delay in giving the plaintiff notice of the frauds committed as recited in the Petition; and this defendant states that at the same time it demanded of the plaintiff as its obligee under the bond herein sued upon, that the plaintiff should not admit any liability, or make any payment, upon said claim until it should be judicially determined that the plaintiff was liable thereon; and this defendant further states that it assured the plaintiff at that time that it, the defendant, would undertake the defense of any suit

to be brought by said depositor upon said claim and bear all expense in connection therewith. And at the same time this defendant demanded of the plaintiff that it make immediate demand upon all prior endorsers of any of said cheques to take up the same by virtue of their endorsements, but that this the plaintiff refused to do.

"The defendant further states that nevertheless in spite of this defendant's said demand that the plaintiff make no admission of liability upon the said claim of its said de-
[fol. 55] positor, the plaintiff on or about the 14th of January, 1926, without the knowledge or consent of this defendant, entered a credit of the sum of $5,512.72 back to the account of its said depositor; but this defendant states that it has not knowledge or information sufficient to form a belief, and therefore it denies that the said credit to the said depositor's account was in whole or in part an absolute or unconditional credit, or that it amounted to a final repayment to said depositor of any amount theretofore charged against it by the plaintiff on account of said cheques or any of them."

B. D. Berry, Attorney for Plaintiff.

IN UNITED STATES DISTRICT COURT

ORDER FILING ANSWER, ETC.—Filed May 6, 1927

Came this day the defendant herein and filed its Amended and Substituted Answer.

Came then the plaintiff and moved the Court to strike out of said Amended and Substituted Answer certain portions, indicated in the written motion.

Came then the plaintiff and demurred generally to the second and third paragraphs of said Amended and Substituted Answer, and this cause is now submitted on said motion to strike out, and on said general demurrer.

This order is to be entered.

——— ———, Judge. B. D. Berry, Attorney for Plaintiff. Wilson & Harbison, Attorneys for Defendant.

May 6, 1927.

[fol. 56] IN UNITED STATES DISTRICT COURT

OPINION OF THE COURT ON PLAINTIFF'S DEMURRER TO SECOND AND THIRD PARAGRAPHS OF DEFENDANT'S AMENDED AND SUBSTITUTED ANSWER AND UPON THE MOTION TO STRIKE THEREFROM—Filed June 8, 1927

This action is before me on plaintiff's demurrer to the second and third paragraphs of defendant's answer and motion to strike certain affirmative allegations from the first paragraph. Inasmuch as these affirmative allegations and the allegations of the second paragraph, which are all affirmative, are made parts of the third paragraph by reference, I will treat all the affirmative allegations of the entire answer together and determine whether any of them constitute a defense to the action to any extent.

The action is on an indemnity bond. The plaintiff is engaged in the banking business at Lexington in this district and the defendant is a surety company. On November 14, 1923 the defendant executed and delivered to plaintiff its bond whereby, in consideration of the payment of certain premiums, it undertook and agreed to indemnify plaintiff to an amount not exceeding $25,000 against any loss sustained by it subsequent to noon of that date and while the bond was in force and discovered by it subsequent to noon of that date and prior to the expiration of twelve months after the termination of the bond as therein provided, "through the payment, whether received over the counter or through the clearing house or by mail of forged or raised checks or (genuine) checks bearing forged indorsements or the establishment of any credit to any customer on the faith of such checks."

The petition alleges the payment of premiums which continued the bond in force from noon of its date until April 8, 1926. It alleges that prior to May 12, 1924, and continuously since that date, the Petroleum Company was and has been one of its depositors; that between that date and July 28, 1925 on different dates that Company drew thirty-nine checks against its account with plaintiff in favor of various persons for various sums; that, as to thirty-five of the checks, the indorsements of the payees thereof were forged by one H. D. Fulton, who also raised the sums to be paid on eighteen of them to larger sums; that, as to four

of them, he so raised the amounts to be paid on them; that in due course, it paid all of these checks, the sums paid on those raised being the sums to which they had been so raised; that on payment of those checks it charged the [fol. 57] sums paid, as paid, to the account of that company; that on September 25, 1925 that company made a written demand on plaintiff to credit its account with the sum of $5,512.72, the total amount of the sums paid on those checks which it should not have paid; that on October 2, 1925 plaintiff in writing notified defendant of this demand and in effect demanded payment thereof from it, which it refused, denying any liability therefor; and that on January 14, 1926 plaintiff credited the account of the Petroleum Company with that sum of $5,512.72 in recognition of its demand that this be done.

The defendant in its answer sets up affirmatively that H. D. Fulton, the forger, was a trusted employee of the Petroleum Company; that he prepared the checks drawn on plaintiff by the company for signature by its officers and after they were signed sent or delivered them to the payees; that he kept the books of account and all financial records of the company and made all entries therein; that he made all the deposits in plaintiff's bank and obtained from it monthly statements of its account with the company and the latter's cancelled checks and that he absconded August 1, 1925. It alleges that each of the checks which were raised was negligently drawn by the Petroleum Company in such a way as to facilitate the raising of the sum to be paid, in that blank spaces were left on the face of each in both places for the designation of the sum to be paid, which rendered it easy to write additional words and figures therein thereby increasing the sum to be paid, without giving the appearance of being altered; that each month from May 12, 1924 to August 1925 it delivered to Fulton for the Petroleum Company a statement of its account with plaintiff and its cancelled checks and it negligently failed to examine them and to discover the forgeries by Fulton sooner than it did and as soon as it could reasonably have done; that the Petroleum Company discovered the forgeries August 1, 1925, when Fulton absconded and that it negligently failed to notify plaintiff thereof until September 25, 1925; and that by reason of these several negligencies on the part of the Petroleum Company plaintiff was not bound

to make good to it the amount claimed by it or any portion thereof and the payment thereof by plaintiff in recognition of that claim was voluntary on its part. It further alleges that plaintiff negligently failed to promptly notify defendant of the forgeries; that as to thirty one of the checks, which had prior endorsements by two banks which paid [fol. 58] them, *plaintiff demanded of plaintiff banks which paid them,* defendant demanded of plaintiff that it notify the prior endorsers of the forgeries and demand payment from them and it failed to do so; and that upon its being notified of the forgeries it claimed to plaintiff that it, plaintiff, was not liable to account to the Petroleum Company for the amounts paid out by it, and demanded of it that it should not admit its liability or make payments on account thereof until it should be judicially determined that it was liable, and assured plaintiff that it would undertake the defense of any suit which might be brought by the Petroleum Company and bear all expense in connection therewith.

The defenses thus alleges and relied on may be thus stated:

1. That plaintiff was not liable to the Petroleum Company on account of the payments complained of because of its negligence in three particulars, in the drawing of the checks, in not discovering the forgeries as soon as it reasonably could and in not promptly notifying plaintiff thereof. Hence its accounting to that company was voluntary.

2. Even though plaintiff was liable to that company it is not entitled to recover of defendant because of its failure to give it prompt notice of the forgeries and because further of its settling with plaintiff without first having its liability judicially determined, thus affording defendant an opportunity to defend against the claim.

3. As to the checks bearing prior endorsements, even though defendant was liable to that company therefor, it is not entitled to recover of defendant because of its failure to promptly notify the prior endorsers of such forgeries and to demand payment thereof from them.

The plaintiff advances but a single consideration in support of its contention that none of what it thus put forward as a good defense to this action is really so to any extent.

It is this, that in paying these checks the plaintiff paid its own money and not the money of the Petroleum Company. It did not thereby in reality reduce its liability to that company a single penny. It remained liable to it for just as much as it did before. It therefore immediately upon such payment sustained the loss of the sums of money which it so paid. The bond indemnified it against such loss and hence it is entitled to recover thereon the sums so paid. It was not bound to look to the Petroleum Company or prior endorsers for reimbursement, but had a right to look direct [fol. 59] to the defendant on its bond. It cites in support of its position these decisions, to-wit:

Henderson Trust Co. vs. Ragan, 52 S. W. 848.

Champion Ice Co. vs. American B. & T. Co., 115 Ky. 863.

Commercial Bank vs. Arden & Fraley, 177 Ky. 520.

Beyond question the payments which it made were with its own money and not with that of the Petroleum Company. But from its point of view and that of the bond it did not thereby suffer any loss. The loss indemnified against by the bond was a loss "through payment" of such checks, i. e. the loss was a consequence of such payment. The payment was not itself a loss within the purview of the bond. The payments were on account of the Petroleum Company and plaintiff at once charged the payments to it and on its books reduced its liability to it to that extent. Its books did not show any loss. The reduction in liability to that company took the place of the cash paid out. And the plaintiff suffered no real loss unless subsequently thereto the Petroleum Company repudiated those charges. This it might or might not do. It was possible, at least, that after it became aware of the forgeries, out of consideration for the forger or for some other reason, it might conclude not to repudiate the charges and to pocket the loss itself rather than let the plaintiff bear it. In such case plaintiff would suffer no loss "through" or by reason of the payment of the checks. Further it might have no right to repudiate them. In such case it would no more suffer loss than it would where it did not in fact repudiate the payments but ratified them. This is one of the positions taken by the defendant by the allegations of its answer. It alleged that the Petroleum Company had no right to repudi-

ate the charges which plaintiff had made against its account of the sums paid on the forged checks and it was not liable to that Company for so much of its account as had been reduced by such payments because of its negligence in three particulars, to-wit; in the drawing of the checks, in not discovering the forgeries as soon as it reasonably could after the return of the monthly statements, and in not promptly notifying defendant of the forgeries after it had discovered them. Possibly there may be some question as to whether the Petroleum Company's right was affected by its negligence in the first of these particulars. The decisions in the cases of Henderson Trust Co. vs. Ragan and Commercial Bank vs. American B. & T. cited by plaintiff may support the position that it was not so effected. But there can be [fol. 60] no question but that its right was affected by its negligence in the second particular. This is settled by the decision of the Supreme Court in the case of Leather Mfg's. National Bank vs. Morgan, 117 U. S. 96, and other decisions cited by defendant.

Possibly the Petroleum Company's negligence in these two particulars only affected its right to repudiate the charges to the extent that they covered the sums over the sums for which the checks were drawn. This on the ground that there was nothing to indicate to the Company that the endorsements were forged. But this is not likely.

But certainly the Petroleum Company's right to repudiate and to recover was affected to the full extent by its negligence in the third particular. The plaintiff was entitled to prompt notice of the forgeries after their discovery if it intended to assert such right.

Generally as bearing on the defense of negligence on the part of the Petroleum Company, reference may be made to the note to 2 Michie on Banks & Banking, 1248, cited by defendant, where it is said:

"Where a bank is relieved from liability for cashing a forged check by the negligence of its depositor and then voluntarily makes good the depositor's loss, such bank cannot thereafter recover the amount of the check from another bank from which the check had been received in settlement of balances Van Wert National Bank vs. First National Bank. 60 C. Ct. 130, 30 C. D. 380."

Neither in such case can it recover the amount so voluntarily paid against a surety company which has agreed to indemnify it against loss through the payment of such a check. If then the allegations of the answer as to the negligences of the Petroleum Company are true the plaintiff suffered no loss by reason of the payments in question and is not entitled to recover from defendant.

The decisions cited and relied on by defendant have no other bearing on this question that as indicated above. So far at least, therefore, the answer presented a good defense. [fol. 61] But it must be held that the other defenses set up are also good. Though plaintiff may have been liable to make good the payments in question to the Petroleum Company it does not follow that plaintiff is entitled to shift its loss to the defendant under its bond. The plaintiff owed two duties to defendant. One was to promptly notify it of the Petroleum Company's claim as soon as it was informed of it and the other was to promptly notify the prior indorsers and demand payment of them. So far as the latter duty was concerned it was not to sue those indorsers, but simply to notify them and demand payment of them, so that they might know that reimbursement from them was expected and they might take such steps as they saw fit to protect themselves. It was plaintiff's duty to do this in order to preserve its right against them to which defendant was entitled to be subrogated if it paid the loss to defendant. The law is thus stated in 2 Michie on Banks & Banking, 1248:

"In determining the right and liabilities as between banks in the case of payments on forged paper, the usual rule applies that to shift the loss sustained upon forged commercial paper, the holder must give prompt notice of the forgery when discovered and return the check to the party upon whom the loss is sought to be cast."

So the usual rule should and does apply to shift the loss so sustained from a Bank to a Surety Company which has undertaken to indemnify it from such loss.

It is possible that plaintiff also owed to defendant the duty of not settling the Petroleum Company's claim until it had been judicially determined, after defendant notified

it not to do so and so settling it released defendant. But I do not find it necessary to determine this.

The demurrer and motion to strike is overruled.

June 7, 1927.

A. M. J. Cochran, Judge.

[fol. 62] In United States District Court

Order Filing Reply, etc.—Filed 6/13/27.

This day came the plaintiff and filed its reply herein, which is noted of record.

This cause coming on to be heard on plaintiff's demurrer to the second and third paragraph of defendant's amended and substituted answer, and on plaintiff's motion to strike out certain affirmative allegations from the first paragraph of said answer, and the Court being sufficiently advised, it is ordered and adjudged that said motions, and each of them, be overruled to which the plaintiff excepts.

In United States District Court

Reply—Filed 6/13/27

I. The plaintiff for reply to the defendant's Amended and Substituted Answer, filed herein, and especially to the first paragraph thereof, says that it is true that the said H. D. Fulton was the bookkeeper of the Petroleum Company, therein named, but it is also true that the said H. D. Fulton was a trusted officer of said Company, to wit, was Vice-President, Director and Treasurer, during all the times herein referred to, and all the times set out and set forth in the petition filed herein.

The plaintiff further denies and says it is not true that the plaintiff wholly failed or failed at all to give to defendant any notice of any irregularity or fraud or loss, in connection with any of said checks until the 22nd day of October, 1925, when it wrote its letter which is copied in plaintiff's petition; but on the contrary, plaintiff says that it wrote its letter, as set out in plaintiff's petition, complying with the requirements of the printed conditions on said

bond, and furnished the defendant the notice as thereon required; but in addition to this, plaintiff says it notified the defendant of the forgeries and irregularities claimed in plaintiff's petition herein, upon its receiving information [fol. 63] from the Petroleum Company of said facts; that it received notice from the Petroleum Company during the first ten days of August, 1925, and that it immediately thereupon notified the defendant of the fact of said forgeries and irregularities and gave to defendant a full, detailed statement of all the information it had at that time; that on or about the 10th day of August, 1925, the Auditors for the Petroleum Company began auditing the books, in order to detect and ascertain the extent of said forgeries and irregularities, and continued in said work for approximately three weeks, and that during the progress of said work, the defendant, through its agents and employes, was present and participated in said investigation.

Plaintiff says that immediately after its said notice to the defendant, said defendant, by its agents, made its own investigation of the facts in connection with said checks, and the forgeries and irregularities incident thereto, and expressed itself as satisfied and convinced that said irregularities and fraud and forgeries, with reference to said checks, existed, as represented to it by the said Petroleum Company, and by said agents indicated its entire satisfaction, that upon such state of facts, so ascertained by it and set out in plaintiff's petition herein, the plaintiff, bank, was liable to the Petroleum Company to reimburse it, the said Petroleum Company, for its said charges against its account, by reason of said forged and raised checks; and defendant further indicated, and expressed itself, that it would not question its liability under its said contract of indemnity to reimburse the said plaintiff in the amount of the said checks so forged and raised.

The plaintiff says it is not true and denies that defendant stated to plaintiff, immediately upon receiving notice of the plaintiff's said claim, or at all, that plaintiff was excused from all liability to said depositor, with respect to said checks, on account of the negligence of said depositor, or for any reason, or on account of said depositor having delayed in giving the plaintiff notice of the fraud committed, as recited in plaintiff's petition; and plaintiff says it is not true and denies that at the same

time, or at any time, the defendant demanded of plaintiff that plaintiff should not admit any liability or make any payment upon said claim until it should be judicially determined that the plaintiff was liable thereon; and plaintiff denies that the said defendant at any time demanded of plaintiff that it would make demand of all prior en-
[fol. 64] dorsers on said checks, or any of them, to take up said check, by virtue of their endorsements thereon, and denies this plaintiff refused to do so.

Wherefore the plaintiff having fully replied, prays as in its petition, for its costs herein, and all proper relief.

II. The plaintiff, for reply to the second paragraph of defendants' Amended and Substituted Answer, says that it is true from the 12th day of May, 1924, and prior thereto, until the 28th day of July, 1925, the said H. D. Fulton was a trusted employe of the plaintiff's depositor, Petroleum Company, but it is also true that during all of the said time, the said H. D. Fulton was a trusted officer in said Company, to-wit: he was Vice-President, Director and Treasurer, during all of said time, but plaintiff denies that the keeping of said books, statements and records was negligently committed to the said Fulton. It says that he had full authority to perform said services, so performed by him, by reason of his official connection with said Company, such authority having been given him on account of his ability and by reason of the long acquaintance with him of the other directors and officers of said Company, they having confidence in his integrity, which confidence they were justified in imposing in him, so far as they knew or any information they could obtain.

Plaintiff denies that it was the negligent habit of said officers to sign or to issue, without question, any check presented by said Fulton for signature, without ascertaining whether the amount of said check was due to the payee thereof or not, and it says that no check was issued by any officer of the said Petroleum Company, unless the correct amount of said check had previously been inserted therein, and further, unless said check was payable to the party to whom said check was due.

Plaintiff denies that each of said checks or any of said checks, set out in the petition, were negligently drawn or issued by the plaintiff's depositor, the Petroleum Company, in such way as to facilitate an alteration or "rais-

ing" on its face of the sum of money ordered thereby to be paid. Plaintiff denies that blank spaces were negligently left by the plaintiff on the face of each or any of said checks in either of the two places for the designation of the sum of money to be paid, in such way as to render it easy to write additional words or figures in said spaces, and thereby increasing the sum of money made payable by the check, without giving it the appearance of having [fol. 65] been altered; and plaintiff says that said blank spaces were filled in on the checks, and each of them, by indicating the name of the payee and the amount of the check, before the signature was attached thereto, although it was customary to have said checks, after they were signed and so completed as herein stated, to pass through a protectograph machine for the purpose of indicating in words the amount of such checks; and that in no manner and in no wise could said checks be tampered with or raised, except by one skilled in the undertaking and with criminal intent, which purpose plaintiff, at no time, anticipated.

Plaintiff says it has not sufficient knowledge or information to form a belief as to whether or not at any time during the period alleged by plaintiff in its answer, to-wit, between the 12th day of May, 1924, and the 1st day of August, 1925, there was no examination of any of said statements of account or cancelled checks made by any other officer of said Petroleum Company than H. D. Fulton himself, or by any other person on behalf of said depositor, except H. D. Fulton himself; and plaintiff denies that it has sufficient knowledge or information to form a belief that but for said alleged negligence of that said depositor in its alleged failure to supervise or check up or examine its books or records, as kept by the said Fulton, or by its alleged failure to use ordinary care in the drawing or issuing of its checks in such form as not to facilitate their being raised, or its alleged failure to examine or inspect its monthly bank statement of account and returned cancelled checks, the frauds complained of in the petition would not have occurred, and the payment of the checks mentioned in the petition would not have been made by plaintiff; and plaintiff denies by reason of said alleged negligence on the part of plaintiff's said depositor, the plaintiff had a good defense or any defense,

against any claim of said depositor to compel repayment or re-crediting of the amount paid by plaintiff on any or all of the said checks; and denies and says it is not true, that if the plaintiff did in fact pay the claim of said depositor in the sum of $5,512.72; as alleged in the petition, or did in fact re-credit said depositor's account in said sum, the plaintiff repaid or recredited said account voluntarily, without being obligated or lawfully compellable.

III. The plaintiff for reply to the third paragraph of defendant's Amended and Substituted Answer, says it is not true and denies that the depositor, to-wit, the Petroleum [fol. 66] Company, did not notify plaintiff of said irregularities or make any demand upon it for repayment of any amount charged against its account by plaintiff, on account of any of said forged or raised checks until the 25th day of September, 1925, but on the contrary plaintiffs says that the Petroleum Company did immediately upon discovering said irregularities, or at any rate within the first ten days of August, 1925, notify plaintiff of the facts in regard thereto, and as and when the said Petroleum Company completed an audit of its account, showing the full extent of said irregularities, it notified the plaintiff again on the 25th day of September, 1925, and during all of the time between the first notification and the last notification, kept plaintiff informed of the progress being made by it, in its investigation of the said Fulton accounts.

Plaintiff further says it is true it never made any demand upon said prior endorsers on said checks referred to in the plaintiff's petition and defendant's answer, upon their endorsements on said checks, but denies and says it is not true that the defendant immediately, or at all, upon learning of the alleged fraud in the negotiation of said checks, demanded of plaintiff that it make such demand upon each of the prior endorsers on said checks.

Plaintiff says at said time it represented and stated to defendant that its claim against defendant was by reason of the bond executed by it to plaintiff and for plaintiff's benefit, under and by the terms of which it undertook to indemnify plaintiff and hold it harmless from any loss not exceeding the amount set forth in said bond, among other things for any loss "through the payment whether re-

ceived over the counter or through the clearing house or by mail or forged or raised checks or (genuine) checks bearing forged endorsements, or the establishment of any credit to any customer on the faith of such checks", and that it, the said defendant, at said time made a thorough and complete investigation of the facts connected with the said irregularities, and by reason of the foregoing facts, this plaintiff represented to defendant and stated that plaintiff's claim should be paid by defendant and not by any prior endorsers on said checks.

Plaintiff stated and respresented to the defendant that if defendant would agree to pay plaintiff's claim herein sued on, that plaintiff would immediately thereupon, if defendant so desired it to do so, make prompt demand upon each and all of said endorsers on said checks for defend-
[fol. 67] ant, for payment of said checks by the said endorsers, by reason of the said endorsements thereon.

Wherefore the plaintiff having fully replied, prays as in its petition herein, for its costs, and for all proper relief.

B. D. Berry, Attorney for Plaintiff.

Duly sworn to by W. H. Courtney. Jurat omitted in printing.

IN UNITED STATES DISTRICT COURT

ORDER FILING STIPULATION, ETC.—Filed Jan. 9, 1928

Came the parties hereunto by their attorneys and filed a Stipulation in writing, waiving a jury, and presenting an agreed statement of the facts upon which this cause should be tried—the filing of which is hereby noted.

It is thereupon ordered that this cause be, and it hereby is, submitted for trial by the Court without the intervention of a jury and upon said agreed statement of facts.

Baily D. Berry, Counsel for Plaintiff. Wilson & Harbison, by Clinton M. Harbison, Counsel for Defendant.

Jan. 9, 1928.

[fol. 68] IN UNITED STATES DISTRICT COURT

STIPULATION OF FACTS—Filed Jan. 9, 1928

It is hereby stipulated by and between the parties hereto that this cause may be submitted upon the following agreed statement of facts:

The plaintiff is and at all times herein mentioned has been a national bank engaged in the banking business at Lexington, Kentucky, and the defendant, a foreign corporation, engaged in the business of a surety company.

On 14th November, 1923, the defendant executed and delivered to the plaintiff the bond copied in the petition; and said bond continued in force until after the filing of this suit.

From a time prior to May 12, 1924, the Petroleum Company, a corporation with its principal office at Lexington, has been a depositor at the plaintiff bank; and from prior to May 12, 1924, till August 1, 1925, one H. D. Fulton was Vice-President and Treasurer of said Petroleum Company and was a member of its Board of Directors, and during the same time he was also its clerk in sole charge of its books of account, cheque-books, pass-books, bank-statements and the like, and was entrusted with the duty of preparing cheques to be drawn upon its account at the plaintiff bank; and the persons who had authority to sign said cheques for the Petroleum Company were Felix M. Miles, its President, and J. Fred Miles, his brother, who, however, was not an officer of the company.

Between the 12th of May, 1924, and the 1st of August, 1925, the plaintiff bank honored and paid the 39 cheques of the Petroleum Company which are filed with the Petition, and charged same, in the total sum of $5,551.72, to the Petroleum Company's account. The payee's endorsement on each of said 39 cheques was made by said H. D. Fulton fraudulently and without right: on 35 of the cheques it was a simple forgery of the endorsement, and on the remaining 4, (3 of which were payable to Fulton himself, and one to "cash"), he 'raised' the amounts, as hereinafter explained, before endorsing and cashing the cheques. Three (3) of the cheques (viz., numbers 1664, 1665 and 1856), were issued from cheque-book stubs marked "Void", and were made payable to persons to

whom the drawer was not indebted, and on 9 others (viz., numbers 1272, 1277, 1515, 1659, 1660, 1746, 1747, 1748 and 1855), Fulton fraudulently changed the name of the payee [fol. 69] and substituted names of other payees to whom the drawer was not indebted.

Twenty-two (22) of the 39 cheques were 'raised' by Fulton; that is, he altered and 'raised' the figure at the right of the cheque, and he inserted, with the protectograph, in the line for the writing out of the amount in words, a larger amount than that shown in figures at the right of the cheque when it was signed by the officer of the corporation.

The cheque-numbers, dates of issue, name of payees—or ultimate payees, where payees' names were changed—amounts, endorsements, and the dates of payment by plaintiff, of all said cheques are shown on said cheques themselves. And on the cheques which were 'raised', the amount for which the cheque was originally drawn is shown in pencil. A schedule of all said cheques, showing the above information in tabulated form, is as follows:

Schedule of the 39 Cheques

No.	Date 1924	Payee	Amt.	Raised amt.	Endorsements after payee's	Date pd. by pl. bank 1924
1272	12 May	Floyd B. Fitch	$ 90	$176 90	H. D. Fulton Lafayette Hotel. Bank of Commerce.	17 June
1277	21 June	F. B. Fitch	17 90	317 90	H. D. Fulton Lafayette Hotel. Bank of Commerce.	24 June
1296	15 June	Floyd Shellito	100 00	.....	H. D. Fulton Lafayette Hotel. Bank of Commerce.	5 Aug.
1297	15 June	Homer Thrawley	108 00	.....	H. D. Fulton Lafayette Hotel. Bank of Commerce.	28 June
1421	27 Sept.	Felix M. Miles	482 80	.....	"H. D. F."	4 Oct.
1445	20 Aug.	H. Thrawley	117 00	.....	Lafayette Hotel	22 Aug.
1486	25 Aug.	Robert Day	25 00	125 00	H. D. Fulton Lafayette Hotel. Bank of Commerce.	27 Aug.

1501	25 Aug.	Felix M. Miles	8.56	88.96	H. D. Fulton Lafayette Hotel. Bank of Commerce.	28 Aug.
1515	29 Aug.	Floyd B. Fitch	1.88	81.88	H. D. Fulton Lafayette Hotel. Bank of Commerce.	3 Sept.
1563	13 Sept.	H. O. Bandel	34.00	.....	H. D. Fulton Lafayette Hotel Co.	18 Sept.
1655	15 Oct.	Floyd Shellito	100.00	.....	Lafayette Hotel.	24 Oct.
1656	15 Oct.	Homer Thrawley	117.00	.....	H. D. Fulton Lafayette Hotel Bank of Commerce	22 Oct.
1659	29 Oct.	John B. Miles	1.20	159.97	.....	7 Nov.
1660	29 Oct.	Floyd B. Fitch	1.20	170.00	.....	1 Nov.
[fol. 70]						
1662	4 Nov.	Whitley Isaacs	10.00	.....	Blue Bird Taxi Co. Everett Glass Guaranty Bank & Trust Co.	1925 14 Feb.
1664	4 Nov.	Floyd B. Fitch	200.00	.....	Lafayette Hotel. Bank of Commerce	1924 6 Nov.
1665	3 Nov.	L. F. Feeley	250.00	.....	H. D. Fulton Lafayette Hotel. Bank of Commerce.	8 Nov.

No.	Date	Payee	Amt.	Raised amt.	Endorsements after payee's	Date pd. by pl. bank
1681	12 Nov.	Carl Burgess	45.00	.....	H. D. Fulton Lafayette Hotel. Bank of Commerce.	15 Nov.
1682	12 Nov.	Clifford Couch	45.00	.....	H. D. Fulton Lafayette Hotel. Bank of Commerce.	14 Nov.
1685	15 Nov.	John Hale	105.00	.....	H. D. Fulton Lafayette Hotel. Bank of Commerce.	25 Nov.
1705	25 Nov.	Floyd Shellito	1.25	111.25	H. D. Fulton Lafayette Hotel. Bank of Commerce.	4 Dec.
1746	16 Dec.	Floyd B. Fitch	34.02	134.02	Lafayette Hotel Bank of Commerce.	30 Dec.
1747	16 Dec.	Hugh E. Williamson	39.37	139.37	Lafayette Hotel Bank of Commerce.	16 Feb.
1748	16 Dec.	Floyd B. Fitch	15.75	115.75	H. D. Fulton Lafayette Hotel. Bank of Commerce.	23 Dec.
	1925					1925
1845	15 Apr.	Sam Hackworth	7.50	77.50	H. D. Fulton	22 May
1846	15 Apr.	The Model Oil Co	15.00	115.00	H. D. Fulton	26 May

1847	15 Apr.	Homer Thrawley	114.92	.....	Lafayette Hotel	9 May
					Bank of Commerce.	
1848	15 Apr.	Robert Day	6.00	146.00	H. D. Fulton	22 Apr.
					Lafayette Hotel.	
					Bank of Commerce.	
1849	15 Apr.	Henry Day	30.00	.....	H. D. Fulton	14 May
					Lafayette Hotel.	
					Bank of Commerce.	
1850	15 Apr.	Ova Day	6.00	66.00	H. D. Fulton	20 May
					Lafayette Hotel.	
					Bank of Commerce.	
1854	20 Apr.	Cash	1.50	150.00	H. D. Fulton	22 Apr.
					Lafayette Hotel.	
					Bank of Commerce.	
1855	22 Apr.	G. Arthur Bush	3.00	225.00	H. D. Fulton	28 Apr.
					Lafayette Hotel.	
					Bank of Commerce.	
	1925					1925
1856	24 Apr.	J. D. Ruse	90.00	.....	H. D. Fulton	28 Apr.
					Lafayette Hotel.	
					Bank of Commerce.	
1882	15 May	H. D. Fulton	12.50	112.50	Lafayette Hotel	18 May
					Bank of Commerce.	

No.	Date	Payee	Amt.	Raised amt.	Endorsements after payee's	Date pd. by pl. bank
1904	8 June	H. D. Fulton	12.50	72.50	Lafayette Hotel Bank of Commerce.	10 June
1915	22 June	H. D. Fulton	12.50	212.50		23 June
1916	28 July	Frank Rice	112.00		H. D. Fulton. Lafayette Hotel. Bank of Commerce.	1 Aug.
1918	23 June	Glen Smith	14.00	314.00	H. D. Fulton	11 July
1919	23 June	Homer Thrawley	179.00	379.00	Wm. A. Waples Agent By (H)"	8 July

[fol. 71] Said Fulton likewise committed similar frauds in connection with cheques of the Swiss Oil Corporation, an affiliated company for which he also worked.

Fulton left Lexington for parts unknown about the 1st of August, 1925; and none of the parties in interest here have since been able to locate him or any property of his.

About the 7th of August, 1925, Fulton's frauds were discovered, and the Petroleum Company shortly thereafter reported orally to the plaintiff that he had absconded and that forgeries by him of some of the 39 cheques in question had been discovered; and it notified the plaintiff that a complete investigation would be promptly made.

Thereafter during August and September said depositor procured an investigation and audit of Fulton's books, and during same a representative of the defendant was advised that said investigation was being made.

The first written notice of said frauds given by the Petroleum Company to the plaintiff was the letter of 25th September, 1925, which is copied into the exhibit marked "Proof of Claim" which is filed with the Petition; and in said letter said depositor called on the plaintiff to re-credit its account with the sum of $5,512.72 claimed to have been improperly charged against it on account of 39 cheques.

The first written notice of said frauds or of the depositor's claim based thereon given to defendant was plaintiff's letter of 2nd Oct., 1925, which is copied in the Petition.

Upon receipt of said letter of 2nd Oct., 1925, defendant made an investigation of the facts, and, through its State Adjuster at Louisville, Paul Kelley, and its local Adjuster at Lexington, H. Ratenburg, carried on communications with plaintiff relative to the responsibility for the loss on said cheques, and on the 25th of November, 1925, the defendant's Louisville agent, Paul Kelley, wrote to its Lexington agent, H. Ratenburg, the following letter, a carbon duplicate of which said Ratenburg thereupon showed to the plaintiff as stating the position then taken by the defendant.

[fol. 72] "Louisville, Ky., Nov. 25, 1925.

H. Ratenburg, Adj., Fayette Bank Bldg., Lexington, Ky.

DEAR SIR:

In re Claim F-11240, Phœnix National Bank & Trust Co.

We are instructed by the Home Office to deny liability of this loss, because it is not believed our Obligee Bank is liable to the two depositors. The delay in notification has been so great and so unreasonable that we believe that the depositors are estopped to recover the loss. At any rate, neither the obligee nor this Company could afford to admit liability or make payment until it had been judicially determined that the delay had not barred our obligee from recovering against prior endorsers. We authorize you to state to Obligee our position as herein expressed, but to give it our assurance that we will take the defense of any suit off its hands and bear all expenses in connection therewith. Of course if it is finally determined that our Obligee is liable, our bond is liable.

In the meantime, demand should be made immediately on the prior endorsers for the return of this money. This demand should have been made by our obligee as soon as it was notified of the loss, because just as the depositors may be estopped by their delay from recovering against obligee bank, in the same manner obligee bank may be estopped from recovering against the prior endorsers if it delays in notifying them of the forgery within a reasonable time after the discovery thereof.

If suit is brought by the two Oil Companies against our obligee bank, it may be that a Kentucky Statute would give the bank a right to bring in the prior endorsers as joint defendants, in order to prevent a circuity of action. It would be still better if the two Oil Companies would sue the drawee bank and all endorsers on the checks jointly, if such a proceeding could be had in Kentucky. This would iron out in one action the liability of the drawee bank to the depositors and the liability of the prior endorsers to the drawee bank.

We trust that the obligee will thoroughly understand our position and will agree with us that it would be foolish and [fol. 73] expensive generosity to admit liability to the Oil Companies, until it is established judicially that the delay

of the Oil Companies has not barred obligee's right, which it would have had otherwise, of recovering from the prior endorsers.

In making demand on the prior endorsers, the bank should merely notify them of the forgeries and ask that the money be returned in order that it may be credited to the account of the Oil Companies. At the same time, the bank should write a letter to the Oil Companies denying liability and stating that it is willing to make demand on the prior endorsers only as a matter of service and that it will credit to the account of the Oil Companies any money which the prior endorsers voluntarily return without suit, but that it will assume no personal responsibility for any part of the loss.

Very truly yours, (Signed) Paul Kelley."

PK-IS.

Thereafter on the 14th of January, 1926, the plaintiff made its formal demand of the defendant by its letter of that date which is copied in the Petition herein; and the defendant by its Louisville agent, Paul Kelley, thereupon wrote the plaintiff as follows:

"Feb. 4th, 1926.

Phœnix National Bank & Trust Co., Lexington, Ky.

GENTLEMEN:

Inc re F—11240, Phœnix National Bank & Trust Company, Lexington, Ky.

We are in receipt of a letter from our Hartford, Conn., Office to which is attached a copy of your letter of January 14th, addressed to the Ætna Casualty & Surety Company at Hartford. We regret that you have seen fit to credit the Petroleum Company's account with the amount of their claim. We have told you in the past and reiterate, that we shall raise no question of our liability for any loss you are legally compellable to pay on account of the forged checks involved in this transaction.

It has been our contention and we still contend, that we are not liable to the Petroleum Company, because, in the first place, we think checks were so negligently drawn that [fol. 74] the depositor could be estopped from recovering

against you. In the second place, most of these checks, for which claim is made, were drawn in 1924 and you were not notified of forgery until September 25, 1925. We were informed by you that the depositor was furnished with monthly statements. There is a duty on the depositor, to examine his returned checks and vouchers and to promptly notify the bank of any alterations in the body of the checks, as well as forgery of the drawee's signature. We believe if they do not do this, they may be estopped from recovering against the bank, especially when the bank has been prejudiced by delay. We regret that you have not seen fit to make demand on prior endorsers. This demand should have been made as soon as you were notified of loss, because delay in notifying prior endorsers of forgery within a reasonable time after discovery is made estops you from recovering against them.

We feel that you will thoroughly understand our position and agree with us that it would be foolish to admit liability to the Oil Companies, until it is established judicially, that the delay of the Oil Companies has not barred your rights of recovery from prior endorsers. We know you will understand, that if you were not legally liable to the depositors, you will need no reimbursement.

You will recall, that we assured you in the past, that we would take the defense of any suit brought by the depositors off your hands and bear all expenses in connection therewith.

Our request that you make demand on, or at least give notice of the forgery to all prior endorsers on checks, is a perfectly reasonable request and we do not know of any case where an Obligee has refused the request of such surety, to take the precaution so obviously necessary. You could not expect to recover under a fire insurance policy, if you stand by and let the building burn when you might easily have put out the fire. It seems to us that that same reasoning applies to this case.

Very truly yours, (Signed) Paul Kelley."

PK-IS.

And to said letter of February 4, the plaintiff replied on February 8 as follows:

[fol. 75] "Lexington, Ky., February 8th, 1926.

Mr. Paul Kelly, Adjuster of Ætna Casualty and Surety Co., Louisville, Ky.

DEAR SIR: We have your favor of the 4th, and while we have had no other communication from your Company in regard to this matter, other than a carbon copy of letter from you to Mr. H. Rattenburg, dated November 25, 1925, which carbon copy stated that you were instructed by the home office to deny liability on this loss, we took it for granted that was final, and your Company did not care to consider further negotiations. This is borne out by the statement in your letter of February 4th, in which you give the reasons for the position of your Company, and which is indeed a disappointment to us.

Your policy indemnifies us against any loss "through the payment whether received over the counter or through the clearing house or by mail of forged or raised checks, or checks bearing forged endorsements"; and yet, in your letter of the 4th, you take the position that we must establish or have established by a judgment of the Court our liability in this matter before you would make any payment. As that is your position, it is indeed unfortunate that that clause did not appear in the policy, when it was offered to us, because if it had been, most assuredly we would never have taken the policy.

We say we are disappointed at the reasons given for this position, because we take it for granted that you do know that the Court of Appeals of this state has stated in a case similar to this:

"The position of appellee was not only that of an insurer but in some sort that of a surety as well, and in both of these capacities its liability is primary and direct. It would be restricting the law of both insurance and suretyship to an absurd degree to say that appellee cannot be held liable until after appellant having exhausted every other remedy or prosecuted to insolvency any others who might be liable is still not reimbursed. In other words appellee's liability does not depend upon whether appellant might collect the stolen $500, from some one else."

We say, in face of these facts, the language of your bond [fol. 76] and the Court of Appeals decision on this question, we cannot understand your position in this matter.

Therefore, we have been compelled to institute suit in the Fayette Circuit Court, as our last resort.

Very respectfully, (Signed) W. H. Courtney, President.

WMC-MOS.

Throughout the communications carried on between the plaintiff and the Louisville and Lexington agents of the defendant as above stated, the defendant insisted that the plaintiff should not admit liability to its depositor the Petroleum Company without a judicial determination of the liability, and offered to take over the defense of any suit that might be brought in the premises by the Petroleum Company against the plaintiff, and furthermore insisted that the plaintiff make demand upon the prior endorsers of all of said 39 cheques which bore endorsements prior to their payment by the plaintiff. But the plaintiff on January 14, 1926, without the knowledge or consent of the defendant, recredited the account of its depositor, the Petroleum Company, with the sum of $5,512.72 without any judicial determination of its liability so to do: and the plaintiff has never to this day made any demand on any prior endorser of any of said 39 cheques.

Thirty-one (31) of the cheques in question were presented to the plaintiff for payment by other banks of the City of Lexington, and said cheques bore the endorsements of said presenting banks. The amount paid by the plaintiff upon said 31 cheques was $3,650.95. And said banks were at the time, and continued to be, abundantly solvent and able to pay the amounts of all of said cheques so endorsed by them.

Felix M. Miles, to whom certain of the cheques in question were drawn payable, and whose endorsement thereon was forged by said Fulton, was the President of the depositor, the Petroleum Company, and Floyd B. Fitch, to whom certain of said cheques were drawn payable, and whose endorsement was likewise forged upon them, was the Secretary of said depositor; and John B. Miles, whose endorsement was likewise forged on one of said cheques, was the brother of Felix M. Miles, and was a director of said company; and H. O. Randel, whose endorsement was likewise forged upon one of said cheques, was the brother-in-[fol. 77] law of J. Fred Miles, who directed the business of said Petroleum Company and had authority to sign cheques

upon behalf of said depositor and did sign 27 of those involved in this suit, as shown by said cheques. Of the other payees of the 39 cheques, all but two were or had recently been employees of the Petroleum Company, and had in the recent past been frequently paid by it, by its cheques, for their services; and all such cheques, endorsed by them and paid and cancelled, were on file at said Petroleum Company's office.

Said H. D. Fulton, the depositors' Vice-President and Treasurer and trusted clerk, was in sole charge of the company's books of account and its cheque-book and bank pass-book and bank monthly statements, and made all the Company's deposits at the plaintiff bank and received regularly from the plaintiff bank at the end of each month the bank's statement showing in detail all deposits made to the credit of the account, and all cheques paid and charged against the account, during the month, and the balances to the credit of the account at the beginning and at the end of the month; and with said statement he obtained also for the Petroleum Company the cancelled cheques themselves which had been paid and charged to the account during the month.

No other officer, agent, employee or member of the depositor company, nor anyone else upon its behalf, (other than Fulton), made entries in the corporation's books or took any supervision of, or made any investigation of, its bank account or of the monthly bank statements or returned cancelled cheques, during the whole period from 12th May, 1924, to 1st August, 1925.

In signing cheques prepared by Fulton for signature, the said J. Fred Miles and Felix M. Miles trusted and relied wholly upon said Fulton as to the accuracy of the cheques and the names of the payees, said Fulton being Vice-President, Treasurer, and a director of the depositor, and having the duties and authority hereinabove stated, which had been given him on account of his ability and of the long acquaintance of certain of the officers and directors with him.

All of said 39 cheques which were 'raised' were completed in writing by Fulton, except that the line for the application of the protectograph was left blank, and were signed, before the application of the protectograph to them. And Fulton was trusted to fill in the line stating the amount of the cheque, with the protectograph, and was charged

[fol. 78] with the duty of delivering the cheques, whether by mail or in person.

At no time between the 12th of May, 1924, and the 1st of August, 1925, did the Petroleum Company or anyone in its behalf give the plaintiff any notice of any irregularity in respect of any of the 39 cheques involved in this suit.

Settlements between the banks at Lexington were made through the clearing house daily, throughout the period herein involved.

The Bankers Blanket Bond upon which this suit is brought, and which is copied into the Petition, and the thirty-nine (39) cheques filed as exhibits with the Petition, and all other exhibits filed with or made part of this Petition, and the letters referred to in this Stipulation, are all made parts of this Stipulation.

And it is agreed that the Court may try this case without the intervention of a jury.

Baily D. Berry, Counsel for Plaintiff. Wilson & Harbison, by Clinton M. Harbison, Counsel for Defendant.

IN UNITED STATES DISTRICT COURT

OPINION OF THE COURT—Filed 1/3/29

This action is before me for judgment. It is to be disposed of on the pleadings and a stipulation of facts. The facts, as stipulated, are substantially the same as alleged by defendant in its answer, to which plaintiff filed a motion to strike and a demurrer, both of which I overruled. On that occasion I handed down a written opinion. I find no reason for changing the views there expressed.

[fol. 79] The plaintiff stresses the decision in the case of Ocean Accident & Guarantee Corporation vs. Old National Bank, 4 Fed. (2nd) 753.

It maintains that it calls for a judgment in its favor. I do not think so. The policy sued on in that case was like the one involved here in that it provided for indemnity against loss. The particular loss provided for and involved was a loss by theft. Bills of lading attached to drafts were stolen from the Bank by an employee of the drawee. The Bank had paid the drawer the value of the bills stolen with-

out adjudication of liability and it was held that it was entitled to recover the amount so paid from the Surety Company on its bond. Liability to the drawer was incurred upon the stealing of the bills stolen but the loss was not incurred until the discharge of that liability by payment to the drawer of their value. Here it may be said that liability to recredit the account of the Petroleum Company accrued upon the plaintiff's charging it with the amounts paid on the checks. The loss called for by the bond would not be sustained until the account was recredited with the amount so charged or same was paid to the Company in cash. It did not occur on the payment of the checks, for the reason stated in the former opinion. Whatever may be said on the question as to whether or not the plaintiff theoretically or actually sustained a loss when the checks were paid it was not the loss which the policy had in view. It had in view the loss which should occur subsequent to the payment of the checks and the charging of them to the Petroleum Company by recrediting the amount paid to its account or paying same in cash. It is true that the plaintiff sustained a loss when it so recredited that Company's account. But such payment was voluntary on its part. That Company was not entitled to have the Bank account to it for the amount which it had so charged. The plaintiff's right of recovery depends on the question whether its accounting to its depositor for that amount was voluntary or not. If it was voluntary no recovery can be had. To hold otherwise would be to have allowed the plaintiff to refuse to account and recover the amount so paid and charged for the defendant and thereby enriching itself to the extent of $5,512.72. It is not now considered and held that if the so accounting had not been voluntary, i. e. if the Bank had been liable to so account to its depositor, it could [fol. 80] not properly so account with its first being adjudged in an action by the depositor against plaintiff that it was liable. In that contingency the defendant would have been liable to the plaintiff upon its so accounting without such an adjudication. The position is that the plaintiff was not then liable to its depositor to so account and this being so its so accounting was voluntary and therefore no recovery can be had.

The important question to be determined, therefore, is whether, at the time the plaintiff accounted to the Petro-

leum Company for the amount charged to its account because of its checks the plaintiff was bound to so account, or was it so doing voluntary. It would seem that the latter alternative is the true one. The payment of the checks covered a period of time extending from May 1924 to August, 1925. During that time at the beginning of each calendar month the plaintiff rendered to the Petroleum Company a statement of the amounts deposited and checks paid the preceding month and balance to its credit at the beginning and end of the month and delivered to the Company the checks which had been so paid and charged to its account. It made no objection to any of the monthly statements rendered by the Bank to it and gave no notice of any irregularity claimed in respect of the payment of any of the checks until September 25, 1925. By reason thereof the Petroleum Company became estopped to dispute the genuineness of the checks in the form in which they were paid.

Leather Mfgs. National Bank vs. Morgan, 117 U. S. 96
Empire Trust Company vs. Caban, 274 U. S. 473
Hennessey Bros. & Evans Co. vs. Memphis Nat. Bank, 129 Fed. 557.
Veneri vs. Draper, 22 Fed. (2nd) 33.

It can make no difference that the Petroleum Company's employee who was guilty of the wrong doing in relation to the checks received the monthly statements and cancelled checks and retained custody of them. The Company entrusted him with this duty and if it exercised no supervision over him, which it did not, it should bear the consequences.

As to the raised checks it would seem that the Petroleum Company was grossly negligent in executing them in a form which readily permitted them to be raised without exciting the suspicion of a careful man and for this additional reason the plaintiff was not bound to account to it [fol. 81] as to them and is not entitled to recover therefrom from defendant.

Brady on Laws of Checks, p. 156 says:

"It is a just rule to require the depositor to exercise reasonable care in the preparation of his checks to the end

that loss may not be thrown unnecessarily upon the Bank."

Particularly is the plaintiff not entitled to recover in view of the fact that before accounting to the Petroleum Company the defendant called its attention to the fact that it was not bound to so account and proposed to bear the expense of defending a suit by the Petroleum Company against Plaintiff. In the face of this notice and proposal, the plaintiff went ahead and accounted to that Company.

American Surety Co. of N. Y. vs. Ballman, 104 Fed. 634.

Thatcher vs. Ætna Co., 287 Fed. 484.

I do not find it necessary to consider and determine whether as to the checks paid by the two other banks, the plaintiff lost its right of action against defendant by the failure to give those Banks notice of their fraudulent character.

The defendant is entitled to a dismissal of plaintiff's petition at its costs.

A. M. J. Cochran, Judge.

Jany. 3, 1929.

[fol. 82] IN UNITED STATES DISTRICT COURT

JUDGMENT—Filed Jan. 12, 1929

This cause having by agreement of the parties been submitted to the Court for judgment upon the pleadings and upon an agreed statement of the facts, and counsel for the respective parties having filed written briefs herein; and the Court having considered the cause and having filed its written Opinion herein on the 3rd day of January, 1929; it is hereby ordered that said Opinion be, and it hereby is, made part of the record herein.

Whereupon, in conformity with said Opinion of the Court, it is hereby adjudged that the Plaintiff take nothing by its suit, and that the Defendant go hence without day; and it is hereby further adjudged that the Defendant recover of the Plaintiff its costs in this behalf incurred, to be taxed by the Clerk of this Court.

To all of the foregoing Judgment the Plaintiff excepts. This 12th day of January, 1929.

A. M. J. Cochran, Judge.

O. K.

Bailey D. Berry, James Park, Attys. for Plaintiff.
Wilson & Harbison, Clinton M. Harbison, Counsel for Defendant.

IN UNITED STATES DISTRICT COURT

PETITION FOR APPEAL TO THE UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT—Filed Mar. 11, 1929

The above named plaintiff, the Phœnix National Bank and Trust Company of Lexington, conceiving itself ag-
[fol. 83] grieved by the Decree and Judgment made and entered herein on the 12th day of January, 1929, in the above entitled cause, does hereby appeal from said Decree and Judgment, and every part thereof, to the United States Circuit Court of Appeals for the Sixth Circuit for the reasons specified in the Assignment of Errors, which is filed herewith, and prays that this appeal may be allowed, and that the Transcript of the Record, proceedings and papers, upon which said order was made, duly authenticated, may be sent to the United States Circuit Court of Appeals for the Sixth Circuit.

James Park, B. D. Berry, Attorneys for Plaintiff.

IN UNITED STATES DISTRICT COURT

ASSIGNMENT OF ERRORS ON APPEAL—Filed Mar. 11, 1929

Now comes the plaintiff, by its solicitors, and says that the decree and judgment in said cause is erroneous and against the just rights of the plaintiff, for the following reasons, viz:

(1) Because the Court erred in overruling plaintiff's motion to strike out of the first paragraph of defendant's amended and substituted answer that portion indicated by said written motion.

(2) Because the Court erred in overruling the plaintiff's general demurrer to the second and third paragraphs of the defendant's amended and substituted answer and to each of them.

(3) Because the Court erred in holding that the plaintiff was not entitled to the relief prayed for in its petition, and in adjudging that the plaintiff take nothing by its suit, and that the defendant go hence without day, at plaintiff's cost.

[fol. 84] (4) Because the Court erred in adjudging that under the pleadings and the agreed statement of facts, to-wit, the written stipulation, the plaintiff was not entitled to recovery, in accordance with the prayer of its petition.

Wherefore plaintiff prays that the judgment of the District Court of the United States for the Eastern District of Kentucky herein may be reversed, with directions to grant the relief prayed for in plaintiff's petition.

James Park, B. D. Berry, Attorneys for Plaintiff.

IN UNITED STATES DISTRICT COURT

ORDER ALLOWING APPEAL TO PLAINTIFF AND FIXING BOND—Filed Mar. 11, 1929

This day came the Phœnix National Bank and Trust Company of Lexington, by James Park and B. D. Berry, its Attorneys, and presented its Petition for Appeal and Assignment of Errors, and upon consideration thereof, it is now ordered and adjudged that said Petition and Assignment of Errors be, and the same are hereby filed, and that the Petition for Appeal be, and the same is hereby allowed to be reviewed in the United States Circuit Court of Appeals for the Sixth Circuit; and that a certified Transcript of the Record be transmitted to said United States Circuit Court of Appeals. Bond on said Appeal is hereby fixed at Two Hundred and Fifty ($250) Dollars.

This day came the plaintiff and offered for filing its Precipe herein, which is ordered filed and noted of record; also came the plaintiff and executed its bond on the appeal

herein in the sum of $250.00, which said bond is now hereby approved.

[fol. 85] A. M. J. Cochran, Judge District Court of United States for Eastern District of Kentucky.

O. K.

Clinton M. Harbison, of Counsel for Defendant.
James Park & B. D. Berry, Attys. for Plaintiff.

Bond on appeal for $250.00, approved and filed March 11, 1929, omitted in printing.

[fol. 86] IN UNITED STATES DISTRICT COURT

PRÆCIPE—Filed Mar. 11, 1929

To the Clerk:

You are requested to prepare a Transcript of Record, to be filed in the United States Circuit Court of Appeals, for the Sixth Circuit, pursuant to an appeal allowed in the above entitled cause, and to include in such Transcript the entire record herein, with the exception of the original answer of the defendant, and with the exception of the checks, filed herein as Exhibits. When said Transcript has been completed, you are requested to deliver same to [fol. 87] the Westerfield-Bonte Company, at 217-219 South Eighth St., Louisville, Kentucky, for printing.

This 11th day of March, 1929.

James Park, B. D. Berry, Attorneys for Plaintiff.

Service of a Copy of the above Præcipe is hereby acknowledged this 4th day of March, 1929, and it is agreed that the Original Answer of the defendant may be omitted from the Record herein, on appeal.

Wilson & Harbison, by Clinton M. Harbison, Attorneys for Defendant.

IN UNITED STATES DISTRICT COURT

ORDER RE RECORD AND EXHIBITS—Filed Mar. 11, 1929

The Clerk is hereby ordered and directed, upon the transmission of a printed copy of this Record to the United

States Circuit Court of Appeals, to also transmit the thirty-nine (39) checks, filed as Exhibits with the petition in this action.

It is further ordered that the Clerk of this Court be, and he is, hereby directed to forward all of the papers, documents or Exhibits, comprising the Transcript of Record to be filed in the United States Circuit Court of Appeals for the Sixth Circuit, except the said original checks, to the Westerfield-Bonte Company, at Louisville, Ky., for printing.

A. M. J. Cochran, Judge.

O. K.

Wilson & Harbison, by Clinton M. Harbison. James Park & B. D. Berry, Attys, for Plaintiff.

[fol. 88] Citation, in usual form, showing service on Clinton M. Harbison, filed March 25, 1929, omitted in printing.

[fol. 89] In United States District Court

Order Extending Time—Filed Apr. 8, 1929

By agreement of parties, plaintiff and defendant, it is ordered that the plaintiff, Phœnix National Bank and Trust Company of Lexington, be, and it is hereby given until and including May 15, 1929 within which to file the printed record herein in the office of the Clerk of the United States Circuit Court of Appeals for the Sixth Circuit.

A. M. J. Cochran, Judge.

O. K.

B. D. Berry, James Park, Attorneys for Plaintiff.
Wilson & Harbison, by Clinton M. Harbison, Attorneys for Defendant.

8 Apr. 1929.

[fol. 90] In United States District Court

Stipulation in re Certification of Record

It is Hereby Stipulated and Agreed that the record, as presented to the Clerk by the printer, may be certified by

the Clerk as a true, full and complete copy, as agreed to by counsel, of the original pleadings, papers and orders, used on the trial of this cause as set forth in the præcipe for transcript, without further comparison by the Clerk, and

It is Stipulated and Agreed Hereby that the record, as presented to the Clerk by the printer, is a true, full and complete copy of the pleadings, papers and orders used on the trial of this case as set forth in the precipe.

B. D. Berry, James Park, Attorneys for Plaintiff.
——— ———, Attorneys for Defendant.

[fols. 91 & 92] Certificates of Clerk omitted in printing.

[fol. 93] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

APPEARANCE OF COUNSEL—Filed May 21, 1929

J. W. Menzies, clerk of said court:

Please enter *my* appearance as Counsel for the Appellant.

B. D. Berry, James Park, Lexington, Ky.

IN UNITED STATES CIRCUIT COURT OF APPEALS

CAUSE ARGUED AND SUBMITTED

February 3, 1930

Before Denison, Hickenlooper, and Anderson, JJ.

This cause is argued by B. D. Berry for Appellant and by C. M. Harbison for Appellee and is submitted to the Court.

IN UNITED STATES CIRCUIT COURT OF APPEALS

JUDGMENT—Filed November 12, 1930

Appeal from the District Court of the United States for the Eastern District of Kentucky

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Eastern District of Kentucky and was argued by counsel.

On consideration whereof, it is now here ordered, and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby reversed and this cause remanded for entry of judgment for plaintiff in accordance with the opinion of this court.

[fol. 94] IN UNITED STATES CIRCUIT COURT OF APPEALS

OPINION—Filed November 12, 1930

Before Denison and Hickenlooper, Circuit Judges, and Anderson, District Judge

DENISON, Circuit Judge:

The appellant bank, plaintiff below, was carrying a deposit for the Petroleum Company, doing business at Lexington. One Fulton was Treasurer of the depositor, and was the clerk in general charge of its business office, books and records. It eventually developed that, over a considerable period, Fulton had been obtaining money from the bank upon his company's checks, by means of forging endorsements or raising checks, or both. During this period, the bank had been carrying the indemnity policy of the appellee, defendant below, which had been issued and continued in consideration of an annual premium, and by which the surety company agreed to indemnify the bank and hold it harmless "from and against any loss sustained by the insured * * * that is to say * * * D. Any loss through the payment, whether received over the counter or through the clearing house or by mail, of forged or raised checks or (genuine) checks bearing forged endorsements." From time to time the bank charged to the

depositor's account all these payments, as made. Running over the period from May 12, 1924, to August 1st, 1925, the bank paid and charged to the depositor 39 such invalid checks, in the total amount of $5,551.00. At the end of each month, the bank rendered to the depositor the customary monthly statement, in which each of these checks was shown as charged against the account, and returned to the depositor, as a voucher, each of the invalid checks. These statements and cancelled checks were delivered to Fulton in the regular course of business, and never came to the notice or knowledge of the depositor in any other way. In August, 1925, Fulton disappeared, and, upon hasty search then made by the bank, some of these checks were discovered, and a complete investigation was undertaken. [fol. 95] During September this was in progress and the surety company was advised. September 25, the depositor made formal demand upon the bank to cancel these 39 charges against its account and recredit it with the total sum which had been improperly charged. This demand was transmitted to the surety company, with the statement that the bank felt compelled to comply therewith, and with a request for indemnity. In reply, the surety company insisted that it was the duty of the bank to decline to make such recredit, and also to take steps against the responsible endorsers upon many of the checks. Nevertheless, the bank, after consideration, did recredit this sum, and then brought this suit against the surety company to recover the amount of the several checks, as being losses suffered under the policy. The parties, by written stipulation, waived a jury and filed an agreed statement of facts. This was treated as presenting one—and only one—issue of law—whether judgment should be for plaintiff or for defendant. The trial judge thought the plaintiff could not recover, filed an opinion giving his reasons therefor, and entered judgment accordingly.

The defenses were two: First, that the loss was suffered when the recredit was made, and that this act was voluntarily done by the bank—in the sense that the bank was not legally obligated to make this recredit, and could have successfully defended any proceeding alleging such liability. Second, that the bank had failed in its duty in taking the necessary steps to charge the endorsers before Fulton, and had thereby pro tanto discharged the surety.

The District Court sustained the first defense and did not pass upon the second.

Appellant urges upon us that the case is controlled by our decision in Ocean Co. v. Old National Bank, 4 Fed. Rep. (2d) 753, and deduces from that opinion the proposition that upon such a policy the insured may recover, even though its assumption and payment of the loss had been voluntary. That opinion should not be so interpreted, in the broad sense necessary to reach this case. There, the payment had been voluntary only in the sense that it had not been compelled by judgment; the liability of the bank to its customer was held to have been clear and certain; the Surety Company's position was that the bank [fol. 96] should have compelled an action to be brought against it and given the Surety Company an opportunity to defend, if defense there might have been; our holding was only that such a clearly apparent liability might be voluntarily recognized and paid by the bank without thereby discharging the surety. In the present case, the defendant's claim is that the bank was under no legal duty to make this recredit (which is said to be the loss involved) and so that the loss was suffered voluntarily, in the complete sense of that word. We think it plain that the consideration of that question here is not substantially affected by our decision in the Ocean case.

The primary question is, when was the loss suffered? We conclude that the moment the bank paid the check over the counter or through the clearing house, its loss was complete. The relation between banker and depositor is that of debtor and creditor; the money with which the check is paid is the money of the bank; its contract with the depositor only entitles it to charge back to, and collect from, the depositor the amount of a valid check so paid. When it pays a forged check, it has no right to make this counter charge, and its loss continues to be its loss. True, the continuance is attended by a contingency—the depositor may ratify the forgery. Such a ratification may be intentional and express, or may be implied as the result of circumstances which estop the depositor from disputing the check. So, in the present case, the loss was suffered and the liability arose from time to time as the checks were paid; and, when finally the bank cancelled the charges and recredited the total, it was not then suffering a loss; it was

abandoning a claim for recoupment of its earlier loss—a claim which at first it did not have. We think, therefore, that the policy should be read as indemnity against the original loss, and not as holding the liability in the air until it can finally be determined whether the bank had a right to make the charge back. It is not reasonable to suppose that the bank intended to buy that kind of indemnity. Banks wish to keep their depositors, not to alienate them. They would desire protection against the payments induced by forgery, not against the uncollectability of claims resulting from such payment.

[fol. 97] The question just discussed seems to be one of first impression; we are not cited to any particularly helpful precedents. Deciding this question as we do, the appellee's argument that the policy does not insure against liability, but only against loss, become immaterial. For example, in American Co. v. Bollman, 104 Fed. 634, there was a bond to secure the performance of a contract and then a bond to the surety to secure it against loss. The loss matured and was suffered only when the amount was fixed by the suit on the first bond. In Thatcher v. Ætna, 287 Fed. 484, the bond indemnified against damages from a tort. It was quite appropriate to think that the parties contemplated protection against damages to be fixed by suit.

The present record does not call upon us to decide what the rights of the parties would be in a case where the forgery had been expressly ratified before claim was made under the policy. Here the loss has been, as between the bank and the depositor, assumed by or clearly fixed upon the bank. We hold now only that the bank is not obliged to contest with the depositor any plausible claim by the latter that it has not become liable for the loss; and that, if there is any reasonable ground of litigation, the bank is not obliged to carry the burden of the resulting controversy. We find here that to the claim of the bank that the depositor was bound because of its failure to object to the monthly statements and returned checks, the depositor answers that it never had any notice of these checks excepting the notice thus given to its agent, Fulton; and, that this was not notice to it, as principal, because the agent had a hostile personal interest in the subject matter. These respective claims present a controversy, held no doubt on each side in good faith, and capable of leading to tedious and expensive, if

not doubtful litigation. It might turn out that such a case would be ruled by Leather, etc., Bank v. Morgan, 117 U. S. 96; conceivably, many facts which now appear or which might develop would distinguish therefrom. It would be most unfortunate for such an issue to be tried in a case to which the depositor was not a party, and where it would not be bound. Whether the Surety Company could have brought in the depositor as a party, or could now recover against it, we need not consider.

[fol. 98] Many—perhaps all—of these checks had been cashed for Fulton by others, and when they were paid by the bank bore endorsements by responsible persons. These endorsers then and there became liable to the bank, if the necessary notice was given. It gave no notice at that time, not knowing of the forgery. After being fully informed, it still gave no notice; but on October 2 reported to the Surety Company that the depositor demanded this recredit and gave the Surety Company full particulars. On November 25, the Surety Company notified the bank that the latter should have given notice at once to all endorsers and should now do so; it again so insisted on February 4; but the bank made no effort to comply.

There is no doubt that prompt notice was necessary in order to shift the loss from the paying bank to the endorser; but that right to shift is one given by the law and is contingent on conditions—one of which is prompt notice. The shift herein involved is given by contract and is unconditional. We have construed this contract—this insurance policy—as intended to transfer the whole loss immediately when suffered and not merely to indemnify against such part of the loss as might not be recoverable in some other way. Under such a construction, the failure of the bank to try to charge endorsers is a defense of the same character as its failure to resist the depositor's demand for recredit. We hold that neither defense is good.

If the Surety Company could get the benefit of any rights the bank had to recover its loss, or part of it, from others, it would be by paying the loss and acquiring these rights through subrogation. (Travellers Co. v. Great Lakes Co. —C. C. A. 6—184 Fed. 426, 430; U. S. Fidelity Co. v. Union Bank—C. C. A. 6—228 Fed. 448, 452). The Surety Co. was doubtless entitled itself to give the necessary notices. Its

request to the bank to do so was not in connection with any offer to pay up its liability, so that it might be entitled to have them given for it; the request was in connection with a denial of all liability.

The judgment must be reversed, and the case remanded for the entry of judgment for plaintiff in accordance with this opinion.

[fols. 99-110] Petition for rehearing, covering 11 pages, filed December 12, 1930, omitted from this print. It was denied and nothing more by order of June 30, 1931.

[fol. 111] In United States Circuit Court of Appeals

Order Denying Petition for Rehearing—Filed June 30, 1931

For the reasons stated in the memorandum filed, the petition for rehearing is denied.

(No memorandum attached to order.)

Clerk's certificate to foregoing transcript omitted in printing.

[fol. 112] Supreme Court of the United States

Order Allowing Certiorari—Filed November 2, 1931

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 36,227. U. S. Circuit Court of Appeals, Sixth Circuit. Term No. 413. The Ætna Casualty and Surety Company petitioner, vs. Phœnix National Bank and Trust Company of Lexington. Petition for a writ of certiorari and exhibit thereto. Filed September 25, 1931. File No. 36,227.

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1931.

No.....

THE AETNA CASUALTY AND SURETY COMPANY, *Petitioner*,

v.

PHOENIX NATIONAL BANK AND TRUST COMPANY, *Respondent*.

PETITION FOR CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioner, a corporation created and doing business under and by virtue of the laws of the State of Connecticut, with its principal office at Hartford in the State of Connecticut, by its counsel respectfully prays that a writ of certiorari be issued by this Court to review the judgment of the United States Circuit Court of Appeals for the Sixth Circuit in the above-entitled cause.

This was an action at law in which was sought recovery of an alleged loss by a bank under an indemnity bond alleged to have been sustained by the payment of raised and forged checks.

The indemnitor, this petitioner, defended on the grounds that:

(1) The respondent voluntarily recredited the amount of $5,512.72 which had been charged to the account of a depositor.

(2) The depositor had been grossly negligent in ascertaining the alleged loss, and, also, in notifying the bank, and by reason thereof it was precluded from any right to hold the bank, respondent here, liable for the loss.

(3) The loss, if any, was suffered by the respondent on the date it recredited the amount to the account of the depositor, and not on the date or dates it paid the raised or forged checks.

(4) The respondent was negligent in giving notice of the alleged loss to the petitioner.

(5) The respondent recredited the amount to the account of the depositor over the protest, and against the advice of the petitioner.

(6) The respondent denied to the petitioner the right to protect itself against the alleged liability by so voluntarily recrediting the amount to the account of the depositor.

(7) The respondent was legally obligated to demand payment from the endorsers of the checks within a reasonable time, before it could assert a legal claim against the petitioner, and this demand it failed and refused to make.

The trial court found:

(a) That the depositor was negligent in drawing the checks, in discovering the perpetrated frauds, and in giving notice to the respondent, and that the respondent, because of its negligence, suffered no loss for which it could hold the petitioner under its bond.

(b) That the respondent failed to comply with two legal duties which it owed the petitioner: (1) to promptly notify it of the alleged claim as soon as it was informed of it, and (2) to promptly notify the prior endorsers and demand payment of them; and by failing to perform these duties it could not shift the loss to the petitioner.

(c) That the loss alleged to have been suffered was not sustained, within the meaning of the provisions of the bond, on the date the several checks were paid, but, if suffered at all, it was on the date the recredit was made.

The trial court, therefore, entered judgment for the defendant, this petitioner.

On appeal the United States Circuit Court of Appeals reversed the judgment of the trial court.

The Appellate Court held:

(a) That the loss was complete the moment the bank paid the check over the counter or through the clearing house, and that the bond should be read as an indemnity against the *original* loss, and "not as holding the liability in the air until it can be finally determined whether the bank had a right to make the charge back."

(b) That the bank is not bound to contest with the depositor any plausible claim by the latter that it has not become liable for the loss; and that, if there should be any reasonable ground for litigation, the bank is not obliged to carry the burden of such a controversy;

(c) That the failure to call upon prior endorsers, and the failure to resist the depositor's demand for recredit were not legal defenses to the action.

Petition was duly filed for a rehearing. The petition was denied and the judgment affirmed on June 30, 1931. It is to review this judgment that the petitioner requests a writ of certiorari.

REASONS WHY A WRIT OF CERTIORARI SHOULD BE GRANTED.

(1) The opinion of the court below decides a most important question of law in a way that is untenable and in conflict with long established principles of law.

(2) The questions presented are of great importance to both banking and insurance business since there is outstanding insurance of the nature here in question representing contingent liabilities of several billions of dollars.

(3) This honorable Court has not, but should pass upon the questions here involved because of their vital importance to the business public generally.

WHEREFORE, the petitioner respectfully prays that a writ of certiorari be issued by this Court directed to the United States Circuit Court of Appeals for the Sixth Circuit directing and commanding it to produce in this Court the entire record in this case for examination and determination by it.

Respectfully submitted,

CHARLES KERR,
Counsel for Petitioner.
736 Transportation Building,
Washington, D. C.

Of Counsel:
CLINTON M. HARBISON,
SAMUEL M. WILSON,
A. K. SHIPE.

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1931

No.....

THE AETNA CASUALTY AND SURETY COMPANY, *Petitioner*,

v.

PHOENIX NATIONAL BANK AND TRUST COMPANY, *Respondent.*

BRIEF FOR PETITIONER.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

OPINION BELOW.

The opinion below is found in 44 Federal (2d) 511 (C. C. A. 6th, 1930), and Petition for Rehearing Denied, June 30, 1931 (R. p. 111).

JURISDICTION.

The jurisdiction of this court rests on Section 240 Judicial Code as amended by Act of February 23, 1925, 43 Stat. 936.

STATEMENT OF FACTS.

This was an action at law brought by respondent against this petitioner to recover the amount of $5,512.72 on a "Banker's Blanket Bond, Standard Form No. 8, Bond No. 132522," issued by petitioner to the respondent. The bond was for $25,000.00. Under its provisions the petitioner "hereby undertakes and agrees to indemnify Phoenix National Bank and Trust Company, Lexington, Kentucky, hereinafter referred to as the insured, and hold it harmless to an amount not exceeding Twenty-five Thousand and no/100th Dollars ($25,000.00) from

and against any loss sustained by the Insured," during the life of the bond. The bond then recited the losses covered by the bond, and, inter alia:

> "D. Any loss through the payment, whether received over the counter or through the clearing house or by mail, of forged or raised checks or (genuine) checks bearing forged endorsement or the establishment of any credit to any customer on the faith of such checks." (R. p. 4.)

During the life of the bond the respondent paid 39 checks of one of its depositors, over a period from June 17, 1924, to August 1, 1925, which had been either raised or contained forged endorsements, or both. (R. pp. 69, 70.) The person who raised the checks, or forged the endorsements, or both, was the Vice President and Treasurer and member of the Board of Directors of the depositor company of the respondent, but without authority to actually sign checks. (R. p. 68.)

The frauds were discovered about August 7, 1925, or approximately 16 months after the first check was fraudulently raised. (R. p. 71.)

The bank, respondent here, sent regular monthly statements to the depositor company showing in detail all deposits made, checks paid and charges against the account during the month, and the balances to the credit of the account at the beginning and end of each month, and with the statement went the cancelled checks which had been charged to the account during the month. (R. p. 77.)

The depositor's first notice of the frauds was given to the bank, this respondent, shortly after August 7, 1925, and the first written notice was given September 25, 1925. (R. p. 71.) The first written notice of the frauds given to this petitioner was by letter from respondent dated October 2, 1925. (R. p. 71.) The petitioner made an investigation and, immediately upon completing it, advised the bank in writing that it was not liable on the bond, due to the negligence of the depositor, and the long delay in notification of the losses; also that the respondent should not admit liability, or make payment, and that the petitioner would take the defense of any suit by the depositor, and bear all expenses in connection therewith. (R. p. 72.)

Thereafter, and without the knowledge or consent of the petitioner, the respondent, on January 14, 1926, recredited the account of its depositor with the sum of Five Thousand Five Hundred Twelve Dollars Seventy-two Cents ($5,512.72), the amount of the raised or forged checks.

On February 3, 1926, the respondent filed its action against this petitioner for the sum of Five Thousand Five Hundred Twelve Dollars Seventy-two Cents ($5,512.72). Action was commenced in the Fayette Circuit Court of Kentucky, and thereafter transferred to the United States District Court for the Eastern District of Kentucky. The case was tried on stipulated facts. In two opinions, one on the pleadings, and another for judgment on the stipulation of facts, the District Court found for the defendant, this petitioner. (R. pp. 56 and 78.) On appeal the United States Circuit Court of Appeals for the Sixth Circuit reversed the judgment. (R. p. 94.) The United States Circuit Court of Appeals on petition for rehearing on behalf of the appellee, this petitioner, denied the same on June 30, 1931. (R. p. 111.)

QUESTIONS OF LAW PRESENTED.

(1) Does the negligence of the depositor of the character shown by the record relieve the bank of liability for the payment of raised or forged checks?

(2) May the bank voluntarily, and over the protest of the indemnitor, recredit to the depositor's account the amount of losses sustained as a result of the frauds here shown, and thereby force the indemnitor to pay the losses under its bond, regardless of the negligence of the depositor?

(3) Is the loss suffered by the bank of the date of payment of the checks, or of the date recredit is made to the account of the depositor?

(4) Is not question three (3) herein novel, and, as said by the lower court, is it not one of first impression?

(5) Is not the indemnitor entitled to avail itself of any deenses it may have against voluntary recredits when there is no legal obligation to make them?

(6) Does not the bank bear the responsibility of notifying

prior endorsers, within a reasonable time of known or discovered forgeries, as a protection to the indemnitor?

SPECIFICATION OF ERRORS.

The court below erred in holding:

(1) That the respondent suffered the loss on the date or dates it paid the raised or forged checks, and not on the date it recredited the amount of such checks to the accounts of the depositor.

(2) That the negligence of the depositor in discovering the frauds and in advising the respondent was not a defense to this action.

(3) That by voluntarily recrediting the amount of the raised or forged checks to the account of the depositor, over the protest and without the knowledge of the indemnitor (this petitioner), the respondent did not defeat its legal right to hold the indemnitor.

ARGUMENT.

I.

THE NEGLIGENCE OF THE DEPOSITOR RELIEVES THE BANK FROM LIABILITY FOR PAYMENT OF RAISED OR FORGED CHECKS.

The facts disclose that the checks in the instant case were so drawn that the amounts thereof might easily be raised, without exciting suspicion. They were drawn by the forger, who was Vice President and Treasurer of the depositor company, and presented by him to the proper official of the depositor company for signature. During the entire period the checks were being raised or forged (16 months), the bank made regular monthly statements to the depositor showing all checks paid, the amounts thereof, and the balance at the beginning and end of each month. Nevertheless, the depositor did not discover, or advise, the depositee of the frauds until after the person who raised the checks and made the forgeries had left its service.

It has been held that when a depositor demands a recredit for forged or raised checks charged to its account, the bank may show that the depositor failed to give reasonable notice of the forgeries which examination of the vouchers and statements revealed, or should have revealed, to the depositor.

England National Bank v. *United States*, 282 Federal 121 (C. C. A. 8th, 1922); *National Surety Company* v. *Stockyards National Bank*, 84 Colorado 563; 272 Pacific 470 (1928); *General Cigar Company* v. *First National Bank*, 290 Federal 143 (C. C. A. 9th 1923); *Stumpp* v. *Bank of New York*, 212 Appeals Division 608, 209 New York Supplement 396 (1925).

Also, in determining the sufficiency of the notification, a depositor, who innocently delegates the examination to a dishonest agent, is held to have such knowledge of the forgery as would have been revealed either through examination by an honest agent, or through reasonable supervision of the dishonest agent's examination.

First National Bank v. *Farrell*, 272 Federal 371 (C. C. A.) 3d, 1921); *Fletcher American National Bank* v. *Crescent Paper Company*, 193 Indiana 329, 139 N. E. 664 (1923); *Critten* v. *Chemical National Bank*, 171 New York 219, 63 N. E. 969 (1902); *Leather Manufacturers Bank* v. *Morgan*, 117 U. S. 96; *Pannonia Building & Loan Association* v. *West Side Trust Company*, 93 N. J. L. 377; 108 Atlantic 240 (1919); 2 Morse, Banks & Banking (6th Edition 1928) Section 472.

In *American Hominy Company* v. *Millikin National Bank*, 273 Fed. 550 (1920), the court held that a depositor was estopped by its negligence (a) in omitting to check its agent for a long lapse of time, and (b) in paying the drafts on forged endorsements.

In *Bartlett* v. *First National Bank*, 247 Illinois 490, 93 N. E. 337, the court said:

> "When one of two innocent parties must suffer loss by reason of the wrongful acts of a third party, the rule is almost universal that the party who has made it possible, by reason of his negligence, for the third party to commit the wrong must stand the loss."

To the same effect is *MacAndrews Company* v. *United States*, 23 Federal (2d) 667 (1928).

In Brady on the Law of Checks, Edition of 1915, at page 156, under the heading of "Duty of Drawer to Exercise Care in Preparing Check" appears the following quotation:

> "Speaking of negotiable instruments generally, it has been held in many jurisdictions that, where the drawer or maker of a bill or note prepares it so carelessly that alterations may easily be made, either by insertion or erasure, without defacing the instrument or exciting the suspicion of a careful man, and the opportunity thus afforded is embraced and the instrument raised in amount, the maker or drawer will be liable upon it as raised to any holder in due course. * * *
>
> "But, whatever may be the just rule in respect to promissory notes and ordinary bills of exchange, it is apparent that there is a ground on which to distinguish checks, for the relation between a bank and its depositor is essentially different from that which is found to exist between the parties to a promissory note or ordinary bill of exchange. In regard to a bill or note no one is bound, in the absence of special agreement, to purchase it or become a party to it in any manner. But a bank is bound to honor its depositor's checks at its peril. Hence it is a just rule to require the depositor to exercise reasonable care in the preparation of his checks to the end that loss may not be thrown unnecessarily upon the bank."

In the leading case, *Leather Manufacturer's National Bank* v. *Morgan*, 117 U. S. 96, 29 L. Ed. 811 (1886), this Court established the rule, which has never been changed, that a depositor's failure to examine his monthly statements of account and cancelled vouchers, and his failure to notify the bank of any error therein for a long period of time, is sufficient of itself to defeat any action by him against his bank to open up and change the stated accounts. It was held that the depositor owes the bank a duty to examine his pass-book (of which the modern equivalent is the monthly statement) and the cancelled checks returned therewith, within a reasonable time and to give the bank timely notice of any objection thereto, and that for failure to observe this rule the depositor may be estopped from later questioning the correctness of the stated account. To the same effect are *Armour* v. *Greene County State Bank*, 112 Federal 631; *Hennessy Brothers & Evans Company* v. *Memphis*

National Bank, 129 Federal 557 (1904); *Stallo* v. *Wagner*, 220 Federal 360 (1914); *General Cigar Company* v. *First National Bank of Portland*, 290 Federal 143 (1923); *Veneri* v. *Draper*, 22 Federal (2d) 33 (1927), and *Empire Trust Company* v. *Cahan*, 274 U. S. 473, wherein this Court, speaking through Mr. Justice Holmes, said:

> "* * * the transactions went on for over two years, and the petitioner (the bank) fairly might expect the respondent (the depositor) to find it out in a month or two if anything was wrong. Careful people generally look over their bank accounts rather frequently."

This same rule has been commented upon and expressed in 2 Williston on Contracts, page 2124, 31 Yale Law Journal, 598, and 24 Columbia Law Review, 469 (May, 1924).

The opinion of the Circuit Court of Appeals in this case is commented upon adversely in the Yale Law Journal, Volume XL, February, 1931, page 660.

II.

THE BANK BY VOLUNTARILY RECREDITING THE ACCOUNT OF A DEPOSITOR WITH THE AMOUNT OF THE RAISED OR FORGED CHECKS, IN THE INSTANT CASE, PRECLUDED ANY RIGHT IT POSSESSED TO HOLD THE INDEMNITOR.

The indemnitor is relieved from the payment of losses which could have been avoided, diminished or recouped elsewhere by the indemnitee. *Names* v. *Dwelling House Insurance Company*, 95 Iowa 642, 64 N. W. 628 (1895); Anson, Contracts (Corbin's Edition 1924) Section 245; 28 Columbia Law Review 202; *American Surety Company of New York* v. *Ballman, et al.* 104 Federal 634 (1900); *Thacher* v. *Aetna, etc., Company*, 287 Fed. 484 (1923).

The indemnitee is under legal obligation diligently to assert or to allow and aid the indemnitor to assert, any reasonable defense to the alleged liability. *Gorman* v. *Williams*, 117 Iowa 560, 91 N. W. 819 (1902); *City of New York* v. *Baird*, 176 N. Y. 269 (1903); *Thacher* v. *Aetna, etc., Company*, 287 Fed. 484.

III.

WHEN WAS THE LOSS SUFFERED?

The answer to this question will largely determine whether or not the judgment of the lower court should be reversed.

In the able opinion of the trial judge he said:

"* * * The loss indemnified against by the bond was a loss 'through payment,' of such checks, i. e. the loss was a consequence of such payment. The payment was not itself a loss within the purview of the bond. The payments were on account of the Petroleum Company and plaintiff at once charged the payments to it and on its books reduced its liability to it to that extent. Its books did not show any loss. The reduction in liability to that company took the place of the cash paid out. And the plaintiff suffered no real loss unless subsequently thereto the Petroleum Company repudiated those charges. This it might or might not do. It was possible, at least, that after it became aware of the forgeries, out of consideration for the forger or for some other reason, it might conclude not to repudiate the charges and to pocket the loss itself rather than let the plaintiff bear it. In such case plaintiff would suffer no loss 'through' or by reason of the payment of the checks. Further it might have no right to repudiate them. In such case it would no more suffer loss than it would where it did not in fact repudiate the payments but ratified them. This is one of the positions taken by the defendant by the allegations of its answer. It alleged that the Petroleum Company had no right to repudiate the charges which plaintiff had made against its account of the sums paid on the forged checks and it was not liable to that Company for so much of its account as had been reduced by such payments because of its negligence in three particulars, to-wit; in the drawing of the checks, in not discovering the forgeries as soon as it reasonably could after the return of the monthly statements, and in not promptly notifying defendant (plaintiff) of the forgeries after it had discovered them.

"* * * If then the allegations of the answer as to the negligences of the Petroleum Company are true the plaintiff suffered no loss by reason of the payments in question and is not entitled to recover from defendant." (R. pp. 59 and 60.)

On this point the U. S. Circuit Court of Appeals said:

> "The primary question is, when was the loss suffered? We conclude that the moment the bank paid the check over the counter or through the clearing house, its loss was complete. The relation between banker and depositor is that of debtor and creditor; the money with which the check is paid is the money of the bank; its contract with the depositor only entitles it to charge back to, and collect from, the depositor the amount of a valid check so paid. When it pays a forged check, it has no right to make this counter charge, and its loss continues to be its loss. True, the continuance is attended by a contingency,—the depositor may ratify the forgery. Such a ratification may be intentional and express, or may be implied as the result of circumstances which estop the depositor from disputing the check. So, in the present case, the loss was suffered and the liability arose from time to time as the checks were paid; and, when finally the bank cancelled the charges and recredited the total, it was not then suffering a loss; it was abandoning a claim for recoupment of its earlier loss,—a claim which at first it did not have. We think, therefore, that the policy should be read as indemnity against the original loss, and not as holding the liability in the air until it can finally be determined whether the bank had a right to make the charge back. It is not reasonable to suppose that the bank intended to buy that kind of indemnity. Banks wish to keep their depositors, not to alienate them. They would desire protection against the payments induced by forgery, not against the uncollectability of claims resulting from such payment." (R. p. 96.)

We submit that the reasoning of the trial court is sound, logical and the more reasonable. On this question we have searched in vain for authority. The expressions of the two lower courts are all we can presently find on the subject. But we submit and urge that the bond by its terms was an indemnity *against* loss and not *against liability for loss*. This distinction has been determined in somewhat similar cases. *Thacher* v. *Aetna, etc., Company*, 287 Fed. 484, 487 (1923).

Further, if the loss was complete the moment the bank paid the check, nevertheless when it charged the amount of the check against the depositor and the depositor ratified the

charge, either expressly or impliedly, the bank's original loss, if any, no longer existed.

It may be assumed, we venture to suggest, that Indemnity Insurance Companies would never write an indemnity bond which would carry with it a guarantee of indemnity immediately upon the payment by the indemnitee of raised or forged checks, without the right to assert and rely upon the long established practice of determining whether the indemnitee had a defense to the claim of the party who asserted the loss. The judgment of the Circuit Court of Appeals not only denies, and completely ignores this well recognized right, but at the same time relieves the depositor from all negligence, however gross. It is not only the right but the duty of the Insurance Company to pay losses only after they are determined, upon investigation to be final, legal and actual.

A determination of the other questions presented depends upon the answer of this Court to the question: "When did the loss occur?" and we do not deem it proper to further burden the Court with the discussions of them, as we confidently believe that this Court will lay down the rule definitely and finally that the bank suffers a loss within the purview of this indemnity bond when, after investigation discloses that the loss is final, legal and actual, it recredits the account of the depositor with the amount paid on raised or forged checks. Any other rule would open wide the doors for fraud to be perpetrated not only on the bank but also on the indemnitor and deny to both the long established right and duty to assert proper defenses to all claims for losses.

Respectfully submitted,

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1931.

No. 413.

THE AETNA CASUALTY AND SURETY COMPANY,
PETITIONER,

v.

PHOENIX NATIONAL BANK AND TRUST COMPANY,
RESPONDENT.

Supplemental Brief for Petitioner.

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1931.

No 413.

THE AETNA CASUALTY AND SURETY COMPANY, *Petitioner*,

v.

PHOENIX NATIONAL BANK AND TRUST COMPANY, *Respondent*.

SUPPLEMENTAL BRIEF FOR PETITIONER.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

OPNION BELOW.

The opinion below is found in 44 Fed. (2d) 511 (C. C. A. 6th, 1930).

JURISDICTION.

The jurisdiction of this Court rests on Section 240 Judicial Code as amended by Act of February 23, 1925, 43 Stat. 936.

STATEMENT OF FACTS.

This was an action at law brought by the respondent against this petitioner to recover the amount of $5,512.72 on a Banker's Blanket Bond, Standard Form No. 8, Bond Number 132522, issued by this petitioner to the respondent. The bond is printed in the record at pages 2 to 7.

Under the provisions of the bond the petitioner agreed to indemnify the respondent to an amount not exceeding $25,000,

against any loss sustained by the respondent which fell within the provisions of the bond. This action was brought as a result of losses alleged to have been suffered, and which it is alleged were covered by Section D of the bond which is as follows:

> "D. Any loss through the payment, whether received over the counter or through the clearing house or by mail, of forged or raised checks or (genuine) checks bearing forged endorsement or the establishment of any credit to any customer on the faith of such checks." (R. 4.)

During the life of the bond the respondent paid thirty-nine checks, all of which were deposited over a period from June 17, 1924, to August 1, 1925, which number of checks had either been raised or contained forged endorsements, or both. (R. 69 and 70.) The person who raised the checks, or forged the endorsements, either or both, was the Vice-President and Treasurer, and a member of the Board of Directors of the depositor company of the respondent, but was without authority to actually sign checks. (R. 68.)

The frauds were disclosed about August 7, 1925, or approximately fifteen months after the first check was fraudulently raised. (R. 71.)

All of the thirty-nine checks which were raised, or contained forged endorsements, were drawn by the person, who actually committed the fraud, in such way that they might easily be raised without exciting suspicion. (R. 77.)

The bank, respondent here, furnished regular monthly statements to the depositor company showing in detail all deposits made, checks paid, and charges against the depositors' account during the month, and the balances to the credit of the account at the beginning and end of each month, together with the cancelled checks which had been charged to the account during the month. (R. 77.)

The depositor's first notice of the frauds was given orally to the respondent shortly after August 7, 1925, and the first written notice was given September 25, 1925. (R. 71.) The first written notice of the frauds was given to this petitioner by letter dated October 2, 1925. (R. 71.)

Immediately after receiving notice of the alleged fraud the petitioner made an investigation and advised the bank that it was not liable on the bond, due to the negligence of the depositor and the long delay in giving notice of the frauds; that the bank should not admit liability to the depositor, make payment, or recredit the losses alleged, and that the petitioner would take the defense of any suit by the depositor and bear all expenses in connection therewith. (R. 72.) Request was also made upon the bank that a call be made upon prior endorsers for payment of the raised or forged checks. That request was not complied with.

Thereafter, and without the knowledge or consent of the petitioner, the respondent on January 14, 1926, recredited the account of the depositor with the sum of $5,512.72, the amount of the raised or forged checks. At that time, notwithstanding the request of the petitioner, the respondent had made no effort to secure a judicial determination of its liability; it had made no effort to investigate and determine whether it was liable to the depositor; nor had it made a call on any prior endorser of any one of the thirty-nine checks which had been raised or forged. (R. 76.) It had also refused to comply with the request of the petitioner not to recredit the amount, and had refused to accede to the request of the petitioner that it permit suit to be instituted by the depositor and the petitioner be allowed to defend it.

On February 3, 1926, the respondent filed its action against this petitioner for the sum of $5,512.72.

The United States District Court for the Eastern District of Kentucky in two opinions, one on the pleadings and the other on the stipulated facts, entered judgment for this petitioner. (R. 56 and 78.) On appeal the United States Circuit Court of Appeals for the Sixth Circuit reversed the judgment and afterwards denied a petition for rehearing. (R. 94, 111.)

SPECIFICATION OF THE ASSIGNED ERRORS OF THE COURT BELOW INTENDED TO BE URGED.

1. Negligence of a depositor in discovering raised or forged checks and in promptly advising the bank of such discovery relieves the bank of liability on the payment of such checks. Long delay in discovering the frauds and in advising the respondent, under the facts in this case, relieved the respondent of any legal obligation to recredit the account of the depositor with the amount paid on the raised or forged checks.

2. This was insurance *against loss* and *not against liability for loss.*

3. By voluntarily recrediting the amount of the raised or forged checks to the account of the depositor, without the knowledge and against the prior protest of the indemnitor (this petitioner) the respondent defeated any legal right it might have had to hold this petitioner liable on the bond.

4. The loss was sustained by the bank on the date that it voluntarily recredited the amount paid on the forged or raised checks to the account of the depositor, and this recredit having been made voluntarily the respondent may not hold this petitioner.

ARGUMENT.

I.

THE NEGLIGENCE OF THE DEPOSITOR RELIEVES THE BANK FROM LIABILITY FOR PAYMENT OF RAISED OR FORGED CHECKS. LONG DELAY IN THE DISCOVERY OF FRAUDS WAS NEGLIGENCE.

1. The facts disclose that the checks in the instant case were so drawn that the amounts thereof might easily be raised without exciting suspicion. They were drawn by the forger, who was Vice-President and Treasurer of the depositor company, and presented by him to the proper official of the company for signature. That officer signed the checks notwithstanding

the fact that they were so drawn that they could be easily raised in amount as, for instance, in many cases they were signed with the line for the application of the protectograph left blank. During the entire period the checks were being raised or forged (approximately fifteen months) the bank made regular monthly statements to the depositor showing all checks paid, the amounts thereof, and the balance at the beginning and end of each month, and returned the cancelled checks themselves. Nevertheless, the depositor company was so negligent that it did not discover and advise the depositee of the alleged frauds until after the perpetrator had absconded.

When a depositor demands a recredit for forged or raised checks charged to an account the bank may show that the depositor failed to give reasonable notice of the forgeries which an examination of the vouchers and statements would, or should, have revealed to the depositor. *England National Bank* v. *United States*, 282 Fed. 121 (C. C. A. 8th, 1922); *National Surety Company* v. *Stockyards National Bank*, 84 Colorado, 563; 272 Pacific, 470 (1928); *General Cigar Company* v. *First National Bank*, 290 Federal, 143 (C. C. A. 9th, 1923); *Stumpp* v. *Bank of New York*, 212 Appeals Division, 608, 209 New York Supplement, 396 (1925).

Further, in determining the sufficiency of the notice a depositor who innocently delegates the examination to a dishonest agent, is held to have such knowledge of the forgery as would have been revealed either through examination by an honest agent, or through reasonable supervision of the dishonest agent's examination. *First National Bank* v. *Farrell*, 272 Fed. 371 (C. C. A. 3d, 1921); *Fletcher American National Bank* v. *Crescent Paper Company*, 193 Indiana, 329, 139 N. E. 664 (1923); *Critten* v. *Chemical National Bank*, 171 New York, 219, 63 N. E. 969 (1902); *Leather Manufacturers National Bank* v. *Morgan*, 117 U. S. 96; *Pannonia Building & Loan Association* v. *West Side Trust Company*, 93 N. J. L. 377, 108 Atlantic, 240 (1919); 2 Morse, Banks & Banking (6th Edition, 1928) Section 472.

In *American Hominy Company* v. *Millikin National Bank*,

273 Fed. 550 (1920), the court held that a depositor was estopped by its negligence (a) in omitting to check its agent for a long lapse of time, and (b) in paying the drafts on forged endorsements.

Assuming that both the bank and the depositor company were innocent of any fraud being perpetrated, it is a fact that the person who perpetrated the fraud was a trusted officer and agent of the depositor company, and as said in *Bartlett* v. *First National Bank*, 247 Illinois, 490, 93 N. E. 337:

> "When one of two innocent parties must suffer loss by reason of the wrongful acts of a third party, the rule is almost universal that the party who has made it possible, by reason of his negligence, for the third party to commit the wrong must stand the loss."

To the same effect is *MacAndrews Company* v. *United States*, 23 Fed. (2d) 667 (1928), wherein the Court said:

> "Where, as here, a fraud has been committed by a third party, and the loss must fall on one of two innocent parties, the law lets it rest on the one whose act made possible the perpetration of the fraud."

See also *Cleve. et al.* v. *Craven Chemical Company, et al.*, 18 Fed. (2d) 711; *Atlantic Life Insurance Company* v. *Rowland, et al.*, 22 Fed. (2d) 126; *Federal Intermediate Bank of Columbia, South Carolina* v. *Mitchell*, 46 Fed. (2d) 301; *Davison* v. *Morgan, et al.*, 50 Fed. (2d) 311.

In the instant case the depositor company entrusted the person who raised the checks with the duty of keeping the books, drawing the checks, depositing them with the bank and receiving the statements and cancelled checks at the end of the month. He was the agent of the depositor, and the bank (the respondent here) recognized him as such. It is clear from the record that the fraud was perpetrated by the person who was entrusted with authority by the depositor. Further, by the negligence of the depositor that person was enabled to perpetrate the fraud. The bank was entirely innocent, and clearly a wrongful act of the agent of the depositor must be

borne by the depositor and not by the bank—especially as the record shows that the official who signed the checks for the depositor company was negligent in many respects.

2. It is the duty of a drawer to exercise due care in the preparation of checks.

In Brady on the Law of Checks, 2d Edition (1926), pp. 207–208, the rule is stated as follows:

> "Speaking of negotiable instruments generally, it has been held in many jurisdictions that, where the drawer or maker of a bill or note prepares it so carelessly that alterations may easily be made, either by insertion or erasure, without defacing the instrument or exciting the suspicion of a careful man, and the opportunity thus afforded is embraced and the instrument raised in amount, the maker or drawer will be liable upon it as raised to any holder in due course. * * *
>
> "But whatever may be the just rule in respect to promissory notes and ordinary bills of exchange, it is apparent that there is a ground on which to distinguish checks, for the relation between a bank and its depositor is essentially different from that which is found to exist between the parties to a promissory note or ordinary bill of exchange. In regard to a bill or note no one is bound, in the absence of special agreement, to purchase it or become a party to it in any manner. But a bank is bound to honor its depositor's checks at its peril. Hence it is a just rule to require the depositor to exercise reasonable care in the preparation of his checks to the end that loss may not be thrown unnecessarily upon the bank."

3. It is established law that the failure of a depositor to examine monthly statements of account and cancelled vouchers, and to notify the bank of any error therein for a long period of time, is sufficient of itself to defeat an action by him against the bank to open up and change the stated accounts. Failure of the depositor to examine the cancelled checks and the monthly statement sent by the bank within a reasonable time after receipt, and to give the bank timely notice of any errors therein, estops the depositor from questioning the correctness of the stated account. *Armour* v. *Greene County State*

Bank, 112 Fed. 631; *Hennessy Brothers & Evans Company* v. *Memphis National Bank*, 129 Fed. 557 (1904); *Stallo* v. *Wagner*, 220 Fed. 360 (1914); *General Cigar Company* v. *First National Bank of Portland*, 290 Fed. 143 (1923); *Veneri* v. *Draper*, 22 Fed. (2d) 33, (1927).

In the leading case of *Leather Manufacturers National Bank* v. *Morgan*, 117 U. S. 96, 29 L. Ed. 811 (1886), this Court, speaking through Mr. Justice Harlan, established the rule as herein stated, and that rule has never been changed. Mr. Justice Harlan, *inter alia*, said:

> "While it is true that the relation of a bank and its depositor is one simply of debtor and creditor, *Phoenix Bank* v. *Risley*, 111 U. S. 125, 127, and that the depositor is not chargeable with any payments except such as are made in conformity with his orders, it is within common knowledge that the object of a pass book (of which the modern equivalent is the monthly statement) is to inform the depositor from time to time of the condition of his account as it appears upon the books of the bank. It not only enables him to discover errors to his prejudice, but supplies evidence in his favor in the event of litigation or dispute with the bank. In this way it operates to protect him against the carelessness or fraud of the bank. The sending of his pass book to be written up and returned with the vouchers is, therefore, in effect, a demand to know what the bank claims to be the state of his account. And the return of the book, with the vouchers, is the answer to that demand, and in effect imports a request by the bank that the depositor will, in proper time, examine the account so rendered, and either sanction or repudiate it. * * * The depositor can not, therefore, without injustice to the bank omit all examination of his account, when thus rendered at his request. His failure to make it or to have it made, within a reasonable time after opportunity given for that purpose, is inconsistent with the object for which he obtains and uses a pass book. * * * Without impugning the general rule that an account rendered which has become an account stated, is open to correction for mistake or fraud, *Perkins* v. *Hart*, 11 Wheat. 256; *Wiggins* v. *Burkham*, 10 Wall. 132, other principles come into operation, where a party to a stated account, who is under a duty from the usages of business or other-

wise, to examine it within a reasonable time after having an opportunity to do so, and give timely notice of his objections thereto, neglects altogether to make such examination himself or to have it made in good faith, by another for him; by reason of which negligence the other party, relying upon the account as having been acquiesced in or approved, has failed to take steps for his protection which he could and would have taken had such notice been given. In other words, parties to a stated account may be estopped by their conduct from questioning its conclusiveness." (Parenthesis supplied.)

Further:

"We must not be understood as holding that the examination by the depositor, of his account, must be so close and thorough as to exclude the possibility of any error whatever being overlooked by him. Nor do we mean to hold that the depositor is wanting in proper care when he imposes upon some competent person the duty of making that examination and of giving timely notice, to the bank, of objections to the account. If the examination is made by such an agent or clerk in good faith and with ordinary diligence, and due notice given of any error in the account, the depositor discharges his duty to the bank. *But when, as in this case, the agent commits the forgeries which misled the bank, and injured the depositor and, therefore, has an interest in concealing the facts, the principal occupies no better position than he would have done had no one been designated by him to make the required examination; without, at least, showing that he exercised reasonable diligence in supervising the conduct of the agent while the latter was discharging the trust committed to him. In the absence of such supervision, the mere designation of an agent to discharge a duty resting primarily upon the principal, can not be deemed the equivalent of performance by the latter.*" (Italics supplied.)

Further:

"So in *Hardy* v. *Chesapeake Bank*, 51 Md. 562, which was also a case where checks forged by the confidential clerk of the depositor had been paid by the bank, and, as shown by the pass book, were charged to his account.

> The court upon an elaborate review of the authorities, said, upon the general question, that 'There is a duty owing from the customer to the bank to act with that ordinary diligence and care that prudent business men generally bestow on such cases, in the examination and comparison of the debits and credits contained in his bank or pass book, in order to detect any drrors or mistakes therein. More than this, under ordinary circumstances, could not be required.' "

The rule established in the *Leather Manufacturers* case, *supra*, has been commented upon in 2 Williston on Contracts, page 2124; 31 Yale Law Journal, 598; 24 Columbia Law Review, 469 (May, 1924).

In *Empire Trust Company* v. *Cahan*, 274 U. S. 473, 71 L. Ed. 1158 (1927), the question involved was whether the bank was liable to a depositor for the frauds perpetrated by the depositor's son who had a general power of attorney to draw checks on depositor's account with the bank. For a period of over two years the son drew checks against the father's account and applied some of the funds to his own use. The trial court and the Court of Appeals held that the bank had sufficient notice to charge it, as a matter of law, with the frauds perpetrated by the son. Mr. Justice Holmes in the opinion of this court, reversing the judgment, *inter alia*, said:

> "The person reposing confidence in the son was not the petitioner (the bank) but the respondent (the father), (National Safe Deposit Savings & Trust Company *v.* Hibbs, 229 U. S. 391, 397, 57 L. Ed. 1241, 1247, 33 Supreme Court Reporter 818), and he himself tells us that his confidence was unlimited. He put his deposits absolutely into his son's power, and the son, if he drew currency, as he might, could do with it as he saw fit. The notice to the bank was notice only of this relation of the parties. The petitioner in permitting the son to draw out the money was permitting only what it, like the respondent's bank, would have been bound to allow even if the deposit had been earmarked as a trust. * * * All that is known is that the respondent did not get the benefit of them. *But we do not place our decision upon that narrow ground.*

For in addition to what we have said, the transactions went on for over two years and the petitioner fairly might expect the respondent to find it out in a month or two if anything was wrong. Careful people generally look over their bank accounts rather frequently." (Italics supplied.)

II.

THE INDEMNITY PROVIDED BY THE BOND IS AGAINST LOSS SUSTAINED ONLY BY THE INSURED AND IT IS NOT AN INSURANCE AGAINST LIABILITY FOR LOSS.

The writing sued on in this action is an "indemnity bond." A somewhat similar bond was characterized in *Ocean Accident Etc. Corporation* v. *Old National Bank*, 4 Fed. (2d) 753 (1925). The bond in this case does not run to or for the benefit of the depositors of the bank. It runs to the bank alone, and it covers only losses sustained by the bank. Where the insurance company by its bond agreed to "indemnify the assured against loss arising or resulting from claims for damages" the Court of Appeals of Kentucky held that the insurance was against loss, not against liability for loss. *Transylvania Casualty Company, et al.* v. *Williams*, 209 Ky. 626, 273 S. W. 536 (1925).

To the same effect is *New York Indemnity Company* v. *Ewen*, 221 Ky. 114, 298 S. W. 182 (1927). The words "indemnify" and "hold harmless," as used in the writing sued upon in that case meant to make whole upon a loss actually suffered, to make good, to put back into the situation one was in before the loss. "Words and Phrases," 1st Series, p. 3539 *et seq.*, and 2 "Words and Phrases," 2d Series, p. 1032 *et seq.*, *U. S. Fidelity and Guaranty Company* v. *Williams*, 129 Atlantic (Md.) 660 (1925.)

The well recognized distinction between insurance against liability and insurance against loss or damage is recognized in *Allen* v. *Aetna Company*, 145 Fed. 881; *Schambs* v. *Fidelity & Casualty Company of New York*, 259 Fed. 55; *Thacher* v. *Aetna Company*, 287 Fed. 484.

It is submitted, therefore, that the obligation of the petitioner under its bond only arises in case the respondent sustained a loss. The petitioner maintains in this case that the respondent sustained no loss, within the terms of the bond, because it was under no legal obligation to the depositor to recredit its account with the amount of the checks. And, as was said in *Wilson* v. *Hite's Executor*, 154 Ky. 61, 157 S. W. 41 (1913):

> "Of course * * * an indemnitee should not be allowed to assert a claim against his * * * indemnitor arising on a fictitious or pretended liability, or on account of a debt that he was not legally liable for."

III.

THE BANK BY VOLUNTARILY RECREDITING THE ACCOUNT OF ITS DEPOSITOR WITH THE AMOUNTS OF THE RAISED OR FORGED CHECKS PRECLUDED ANY RIGHT IT POSSESSED TO HOLD THE INDEMNITOR.

The indemnitor is relieved from the payment of losses which could have been avoided, diminished, or recouped elsewhere by the indemnitee: *Names* v. *Dwelling House Insurance Company*, 95 Iowa, 642, 64 N. W. 628 (1895); Anson, Contracts (Corbin's Edition, 1924), Section 245; 28 Columbia Law Review, 202; *American Surety Company of New York* v. *Ballman, et al.*, 104 Fed. 634 (1900); *Thacher* v. *Aetna, etc., Company*, 287 Fed. 484 (1923).

The *American Surety Company of New York* v. *Ballman, et al.*, 104 Fed. 634 (1900), like the present case, was an action on an indemnity bond. It appeared that a suit had been brought against the indemnitee, and the indemnitors had been engaged in defending the suit, and after judgment against the indemnitee and while the indemnitors were perfecting an appeal from that judgment, the indemnitee, without the knowledge or consent of the indemnitors, paid the judgment. Thereupon

when the indemnitee brought suit against the indemnitors on the bond, the indemnitors took the position that the indemnitee's voluntary payment of the judgment had released them, the indemnitors, and in this position they were sustained by the Court.

In *Thacher* v. *Aetna, etc. Company, supra,* the indemnitor had issued a policy agreeing to indemnify the assured against damages from the operation of his automobile. The assured's daughter while driving his automobile ran over and killed a man. The administratrix of the deceased brought suit against both the assured and his daughter. The Court held the assured not liable for the tort of his daughter, and from this judgment an appeal was taken. During the pendency of the appeal the assured compromised the judgment, over the objection of the indemnitor, which maintained that the assured was not liable. The assured then sued the indemnitor on the indemnity policy. The Court held that the assured could not recover, saying:

> "It is clear that the plaintiff in error voluntarily assumed liability for the judgment against his daughter and paid the same before any liability as to him had been established in a suit instituted by his daughter against him, and that this suit is brought against defendant prior to the establishment of any claim against plaintiff, and without any refusal by defendant to defend him in a suit to establish his liability. Therefore under the contract of insurance he can not recover the amount paid by him in adjustment of his daughter's liability."

Applying that principle to this case, had the depositor sued the bank to compel the recrediting of its account with the amount of the thirty-nine checks, and had the bank then voluntarily paid its depositor over the objection of its indemnitor, even after the judgment in favor of the depositor, and pending an appeal from that judgment, such a voluntary action on the part of the bank would have released the indemnitor, this petitioner. That principle would seem to make it all the more certain that a voluntary payment by the bank to the

depositor over the objection of the indemnitor, and even before suit was instituted, would operate as a discharge of the indemnitor.

Further, the indemnitee is under legal obligation diligently to assert, or to aid the indemnitor to assert, any reasonable defense against an alleged liability. *Gorman* v. *Williams*, 117 Iowa, 560, 91 N. W. 819 (1902); *City of New York* v. *Baird*, 176 N. Y. 269 (1903); *Thacher* v. *Aetna, etc., Company*, 287 Fed. 484.

The opinion of the Circuit Court of Appeals in this case was commented upon adversely in Yale Law Journal, Volume XL, February, 1931, pages 660, 662, as follows:

> "* * * Further, under penalty of releasing the indemnitor entirely, he (the indemnitee) is required diligently to assert, or to allow and aid the indemnitor to assert, any reasonable defense to his alleged liability. In the present case there was such a reasonable defense.
>
> "* * * In the instant case the final incidence on bank or depositor of the loss that occurred on payment of the checks was dependent on subsequent events. This the court renders immaterial by its construction of the word 'loss.' The logical result of the view taken in the case would be that, even if the depositor had expressly rather than impliedly ratified the payment, indeed even if no recredit had been made, the defendant would be liable for the amount of the forged checks; no event subsequent to the payment could affect its liability. Refusing to proceed to this length, the court is in a dilemma. If it were a new question, the court's construction of the word 'loss' might perhaps find justification in the words of the policy, but the parties should be deemed to have contracted with reference to the prevailing view that 'loss' in an indemnity contract means only final, legal, actual loss to the indemnitee."

IV.

THE LOSS, IF ANY, WAS SUSTAINED BY THE BANK ON THE DATE THAT IT VOLUNTARILY RECREDITED THE AMOUNT PAID ON THE FORGED OR RAISED CHECKS TO THE ACCOUNT OF THE DEPOSITOR, AND THIS RECREDIT HAVING BEEN MADE VOLUNTARILY THE RESPONDENT MAY NOT HOLD THIS PETITIONER.

Finally, we submit that the loss, if any, was sustained by the bank on the date it recredited the account of the depositor with the amount paid on the raised or forged checks. On this proposition we respectfully quote from the opinions of the United States District Court and the United States Circuit Court of Appeals. The Trial Judge said:

"* * * The loss indemnified against by the bond was a loss 'through payment,' of such checks, i. e., the loss was a consequence of such payment. The payment was not itself a loss within the purview of the bond. The payments were on account of the Petroleum Company and plaintiff at once charged the payments to it and on its books reduced its liability to it to that extent. Its books did not show any loss. The reduction in liability to that company took the place of the cash paid out. And the plaintiff suffered no real loss unless subsequently thereto the Petroleum Company repudiated those charges. This it might or might not do. It was possible, at least, that after it became aware of the forgeries, out of consideration for the forger or for some other reason it might conclude not to repudiate the charges and to pocket the loss itself rather than let the plaintiff bear it. In such case plaintiff would suffer no loss 'through' or by reason of the payment of the checks. Further it might have no right to repudiate them. In such case it would no more suffer loss than it would where it did not in fact repudiate the payments but ratified them. This is one of the positions taken by the defendant by the allegations of its answer. It alleged that the Petroleum Company had no right to repudiate

the charges which plaintiff had made against its account of the sums paid on the forged checks and it was not liable to that Company for so much of its account as had been reduced by such payments because of its negligence in three particulars, to-wit; in the drawing of the checks, in not discovering the forgeries as soon as it reasonably could after the return of the monthly statements, and in not promptly notifying defendant (plaintiff) of the forgeries after it had discovered them.

"* * * If then the allegations of the answer as to the negligences of the Petroleum Company are true the plaintiff suffered no loss by reason of the payments in question and is not entitled to recover from defendant." (R. 59 and 60.)

The opinion of the United States Circuit Court of Appeals held:

"The primary question is, when was the loss suffered? We conclude that the moment the bank paid the check over the counter or through the clearing house, its loss was complete. The relation between banker and depositor is that of debtor and creditor; the money with which the check is paid is the money of the bank; its contract with the depositor only entitles it to charge back to, and collect from, the depositor the amount of a valid check so paid. When it pays a forged check, it has no right to make this counter charge, and its loss continues to be its loss. True, the continuance is attended by a contingency,—the depositor may ratify the forgery. Such a ratification may be intentional and express, or may be implied as the result of circumstances which estop the depositor from disputing the check. So, in the present case, the loss was suffered and the liability arose from time to time as the checks were paid; and, when finally, the bank cancelled the charges and recredited the total, it was not then suffering a loss; it was abandoning a claim for recoupment of its earlier loss,—a claim which at first it did not have. We think therefore, that the policy should be read as indemnity against the original loss, and not as holding the liability in the air until it can finally be determined whether the bank had a right to make the charge back. It is not reasonable to suppose that the bank intended to buy that kind of indemnity. Banks wish to keep their depositors,

not to alienate them. They would desire protection against the payments induced by forgery, not against the uncollectability of claims resulting from such payment." (R. 96.)

The expressions of the two lower courts are all we can presently find bearing directly on the subject. The reasoning of the trial court appears to us to be the more sound and logical. The bond by its terms was *an indemnity against loss* and *not against liability for loss*. The loss having been sustained on the date of recredit, there being no obligation on the part of the bank to make a recredit, the recredit having been made voluntarily, over the prior protest and without the knowledge and consent of the indemnitor, it is respectfully submitted that no liability attaches under the bond.

We further urge that, even if the loss was complete the moment the bank paid the check, as held by the Circuit Court of Appeals, nevertheless, when the bank charged the amount of the checks against the depositor and the depositor ratified the charge, either expressly or impliedly, the bank's original loss no longer existed. That is to say, if the depositor was negligent in the drawing of its checks, or took an unreasonably long time to discover the fraud, there would be such a ratification of the charge against its account the bank would be relieved from liability and the bank would, therefore, sustain no loss, and the petitioner would not be liable.

We venture to suggest, if we may, that Indemnity Insurance Companies would not write an indemnity bond which would carry with it a guarantee of indemnity immediately upon the payment by the indemnitee of raised or forged checks, if it did not have the right to assert and rely upon the long established practice of determining whether the indemnitee had a defense to the claim of the party who asserted the loss. The judgment of the Circut Court of Appeals not only denies, and completely ignores this well recognized right, but at the same time relieves the depositor from all negligence, however gross. It is not only the right but the duty of the insurance company to pay losses only after they are determined, upon investigation,

to be legal and actual. Any rule other than that for which we are here contending, we respectfully submit, would subject the bank, and the indemnitor, to unlimited frauds and would deny to each the long established right and duty to assert all proper legal defenses against claims for losses.

Respectfully submitted,

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IN THE

SUPREME COURT of the UNITED STATES

OCTOBER TERM, 1931.

No. 413

THE AETNA CASUALTY AND SURETY CO.,
Petitioner,

v.

PHOENIX NATIONAL BANK AND TRUST CO.,
Respondent.

Brief for Respondent.

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IN THE

SUPREME COURT of the UNITED STATES

OCTOBER TERM, 1931.

No. 413

THE AETNA CASUALTY AND SURETY CO.,
Petitioner,
v.
PHOENIX NATIONAL BANK AND TRUST CO.,
Respondent.

Brief for Respondent.

The petitioner seeks a review, by writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit, of the judgment of said Court entered November 12, 1930, pursuant to a written opinion filed on said date and found in 44 Federal, (2nd) 511. The petition for rehearing was denied on June 30, 1931 (R. p. 111).

FACTS

The facts are substantially as stated in petitioner's brief, with such exceptions and additions as may be hereinafter referred to and set forth.

ARGUMENT

This case involves the construction of a bond executed by the petitioner, The Aetna Casualty and Surety Company, to the respondent, Phoenix National Bank and Trust Company; the

cause was argued and submitted in the Circuit Court of Appeals of the Sixth Circuit on February 3, 1930; after mature deliberation the uanimous opinion of the Court was delivered November 12, 1930, and a petition for rehearing filed December 12, 1930, was denied on June 30, 1931. This opinion, carefully considered and unanimously concurred in, gives a construction to the contract of insurance involved which is supported by established principles of law, and is sound and logical.

I.

THE RELATION BETWEEN BANK AND DEPOSITOR IS THAT OF DEBTOR AND CREDITOR, AND THE BANK PAID OUT ITS OWN MONEY UPON THE CHECKS, RAISED AND/OR WITH FORGED ENDORSEMENTS.

The rule that the relationship between a bank and a general depositor is that of debtor and creditor is fundamental and if the bank pays checks which have been raised or upon which there is a forged endorsement of the payee's name, the bank pays out its own money and not that of the depositor.

In the case of Henderson Trust Company v. Ragan, 21 Ky. Law Reporter, 601, 52 S. W. 848, the Court said:

> "The rule is well settled that, if a bank pays a check on a forged endorsement, it must sustain the loss. Tied. Com. Paper, par. 449. Where money is paid upon a pretended, not a real endorsement of the name of the payee, in law, the check remains unpaid and can not diminish the funds of the borrower in the bank or the money in the pocket of the person entitled to the payment. Bank v. Whitman, 94 U. S. 347."

In Rice v. Citizens National Bank, 21 Ky. L. R. 346, 51 S. W. 454, the Court said:

> "A deposit in bank of an ordinary deposit creates the relation of debtor and creditor . . . . It is immaterial whether this deposit of $700.00 be treated as a general deposit or as a deposit for a special purpose other than bailment. The money was paid out precisely as the special instructions with the deposit provided, except that the signatures of the payees of the checks were forged. The principle seems to be well settled that a payment by a bank of a check to any person save the payee himself, except it be payable to bearer, is a payment at its peril. If the signature of endorsement is genuine, it is a payment out of the depositor's fund; if it is forged it is a payment out of the bank's funds and the depositor can not be charged with it. Shipman v. Bank (N. Y. App.), 27 N. E. 371; Hatton v. Holmes (Cal.), 31 Pac 1131; Bank v. Whitman, 94 U. S. 347; Bank v. Morgan, 117 U. S. 112; Bank v. Burke (Ga.) 7 S. E. 739, and many other cases . . . . We conclude that the bank is liable to appellants for this deposit. The payment on a forged check was a payment by appellee at its peril. It was not a payment of apellant's funds, however great the care used by the appellee. It is not a question of care or negligence. The payment was not to the payee of checks but a payment on what purported to be his order. The order (endorsement on the check) was a forgery. For this payment appellants are in no way liable. There was no relation of principal and agent between the appellants and appellee. It was pure debtor and creditor."

When the bank paid the various checks with forged endorsements, it paid out its own money and sustained a loss as and when the respective checks were paid.

The opinion of the Circuit Court of Appeals states the rule as follows:

> "The relation between banker and depositor is that of debtor and creditor; the money with which the check is paid is the money of the bank; its contract with the deposi-

tor only entitles it to charge back to, and collect from, the depositor the amount of a valid check so paid. When it pays a forged check it has no right to make this counter charge, and its loss continues to be its loss."

II.

THE LOSS COVERED BY THE POLICY WAS INCURRED BY THE BANK AS AND WHEN THE VARIOUS CHECKS WERE PAID.

An analysis of the language of the bond or policy of indemnity insurance involved in this case shows that the loss of the bank as and when the checks were paid was the loss covered by the bond.

In the case of Fitchburg Savings Bank v. Massachusetts Bonding and Insurance Company, Mass. , 174 N. E. 324, (1931) a question very similar to the one involved in this case arose. This suit was upon a "Banker's Blanket Bond." By methods we need not relate, the Treasurer of the insured bank, through his fraud and dishonesty, abstracted from the bank about $50,000.00, and the bank in the transactions received several notes with endorsers thereon. The surety company contended that the loss covered by the bond was the net amount irrecoverable after all rights against others than the surety had been exhausted. The court said:

> "In this bond the word 'loss' means the deprivation or dispossession of money or property of the bank due to the dishonest, criminal or fradulent acts of its officers, regardless of the security the bank has for the loss, and that the 'loss' occurred and was suffered by the plaintiff, without regard to its possible remedies, when its funds in fact were diverted on October 8, and 10, 1925, through the fraud and dishonesty of its treasurer. Forbes v. Manufacturers' Ins. Co.;

1 Gray, 371; Queenan v. Palmer, 117 Ill. 62, 619, 629, 7 N. E. 470, 613; Mitchell Grain & Supply Co. v. Maryland Casualty Co., 108 Kan. 379, 384, 195 P. 978, 16 A. L. R. 1488; First National Bank of Crandon v. United States Fidelity & Guaranty Co., 150 Wis. 601, 607, 137 N. W. 742; American Surety Co. of New York v. Lawrenceville Cement Co. (C. C.) 96 F. 25, 30; Champion Ice Manuf. & Cold Storage Co. v. American Bonding & Trust Co., 115 Ky. 863, 874, 75 S. W. 197, 103 Am. St. Rep. 356."

In construing the language of the bond so as to thus define the loss covered thereby, the Court said:

"The evidence would not warrant a finding that the plaintiff had exhausted every remedy it has against Nichols and the indorsers on the notes. It is, therefore, the contention of the defendant that the plaintiff has sustained no loss, or if it has, that it can recover nominal damages only.

"A definition of the loss for which the defendant as surety is liable as the net amount irrecoverable after all rights against others than the surety have been exhausted clashes with several sections of the bond. Section 6 provides that '* * * * the Underwriters upon payment of any loss hereunder shall become subrogated to all the rights and remedies of the Insured in respect of such loss.' Section 9 provides: 'At the earliest practicable moment, and at all events not later than ten days, after the Insured shall discover any loss hereunder, the Insured shall give the Underwriter notice thereof by registered letter or telegram. * * * Legal proceedings for recovery of loss hereunder shall not be brought * * * after the expiration of twelve months from the discovery of such loss. If any limitation embodied in this paragraph is prohibited by any law controlling the construction hereof, such limitation shall be deemed to be amended so as to be equal to the minimum period of limitation permitted by such law.' Under the provisions of the contract it is obvious that the definition of 'loss' suggested by the defendant as the measure of its liability under its contract with the plaintiff might result in denying the insured a remedy altogether through its inability to exhause its rights against third persons within the limitations of time allowed in the

bond for bringing actions against the defendant. It is plain such a result unless absolutely required should not be held to express the intention of the parties. American Surety Co. v. Pauly, 170 U. S. 133, 144, 18 S. Ct. 552, 42 L. Ed. 977."

The same may be said as to the bond in the present case. It provides (1) that the insured shall give written notice of any loss as soon as possible after learning of such loss; (2) that the insured shall, within ninety days after learning of such loss, file an itemized proof of claim duly sworn to; (3) that no action shall be brought under the bond in regard to any loss unless begun within twelve months after the insured shall learn of such loss.

If the contention of the petitioner should prevail that the loss for which it is answerable is the net amount irrecoverable after all rights against others, including the depositor, have been exhausted, the result would probably be a denial to the insured of a remedy upon the bond through its inability to have judically determined the controversy with the depositor, and to exhaust its remedies against endorsers of the checks—in other words, to attempt to recoup its loss—within the limitations of time allowed in the bond for bringing actions thereon. No doubt if the bank had required the depositor to sue it and had brought suit against the endorsers of the checks, the year within which it could, under the terms of the bond, file suit thereon would have expired before such litigation had terminated.

The only provision in the bond involved in the above cited case, of those referred to by the court as supporting its conclusion that the loss covered by the bond occurred when the bank's funds were diverted and paid out, without regard to a possible recoup-

ment, which is not found in substance in the bond in the present case, is that which provides that the insurer shall, upon payment of any loss, be subrogated to the rights and remedies of the insured with respect to such loss. The absence of such a provision is not material, because as a matter of law the insurer had such right. On this point the Circuit Court of Appeals said:

> "If the Surety Company could get the benefit of any rights the bank had to recover its loss, or part of it, from others, it would be by paying the loss and acquiring these rights through subrogation. (Travellers Co. v. Great Lakes Co.,—C. C. A. 6,—184 Fed. 426, 430; U. S. Fidelity Co. v. Union Bank,— C. C. A. 6,—228 Fed. 448, 452). The Surety Co. was doubtless entitled itself to give the necessary notices. Its request to the bank to do so was not in connection with any offer to pay up its liability, so that it might be entitled to have them given for it; the request was in connection with a denial of all liability."

An adjudication between the respondent bank and its depositor that the loss arose by and upon the payment made by it as the checks raised and with forged endorsements were presented to it, continued to be its loss, is not a condition precedent to recovery against the Surety Company upon its bond. Ocean Accident & Guaranty Corporation v. Old National Bank, 4 Fed., (2nd) 753.

III.

THE BANK WAS NOT REQUIRED TO RECOUP OR ATTEMPT TO RECOUP ITS LOSS SUSTAINED THROUGH PAYMENT OF THE CHECKS BEFORE PROCEEDING AGAINST THE INSURER.

Without again quoting therefrom, the case of Fitchburg Savings Bank v. Massachusetts Bonding and Insurance Company,

supra establishes the proposition that the insured need not recoup its loss before suing upon the bond and obtaining judgment against the Surety Company.

In Champion Ice Manufacturing Co., v. American Bonding Co., 115 Ky. 863, 75 S. W. 200, the court said:

> "It would be restricting the law of both insurance and suretyship to an absurd degree to say that appellee cannot be held liable until after appellant, having exhausted every other remedy or prosecuted to insolvency any other who might be liable, is still not reimbursed. In other words, appellee's liability does not depend upon whether appellant might collect the stolen $500, from some one else, having a right of acton against the defaulter, Weitkamp, but appellant has also the right of action against the guarantor of his honesty."

In First National Bank v. U. S. Fidelity and Guaranty Company, 137 N. W. 744, the Court said:

> "If the plaintiff were required to exhaust its remedies against Price and Eidsmoe before it could have recourse against the defendants, it might well be that it could not comply with the conditions of the bond at all, because it might not be able to enforce its remedies against these parties within the time which the bond attempts to limit for commencement of suit thereon. It appears to be quite clear that the language of the bond gives the plaintiff an absolute right to recover its loss from the surety as soon as it occurs, and not the qualified one to recover only so much of the loss as cannot be recovered from those responsible for it."

25 Corpus Juris, 1111, reads as follows:

> "A fidelity bond, indemnifying aganst dishonesty, is essentially an insurance contract, guaranteeing the payment, and not a mere guarantee of collection, upon which the insured can recover only after exhausting his remedies against those primarily liable."

To the same effect is the case of Saridersville Oil Mill Co. v. Globe & Rutgers Fire Insurance Co., 124 S. E. 728.

IV.

THE BANK WAS NOT REQUIRED UNDER THE TERMS OF THE POLICY TO LITIGATE WITH ITS DEPOSITOR IN AN ATTEMPT TO RECOUP ITS LOSS, BECAUSE (1) IT DESIRED TO KEEP ITS DEPOSITORS AND NOT TO ALIENATE THEM; (2) IT PROBABLY WOULD HAVE BEEN UNSUCCESSFUL IN THE LITIGATION BECAUSE (a) A DEPOSITOR IS UNDER NO DUTY TO EXAMINE CANCELLED CHECKS FOR FORGED ENDORSEMENTS; (b) NOTICE TO A DEPOSITOR'S AGENT HAVING A HOSTILE PERSONAL INTEREST IS NOT NOTICE TO THE DEPOSITOR; (c) THE DEPOSITOR, THOUGH IT WERE NEGLEGENT IN EXAMINING THE CANCELLED CHECKS, MIGHT HAVE ESTABLISHED THAT THE BANK WAS NEGLIGENT IN PAYING THE CHECKS, AND (3) HAD THE DEPOSITOR PREVAILED IN THE LITIGATION IT WOULD PROBABLY HAVE BEEN TOO LATE UNDER THE TERMS OF THE BOND TO SUE THEREON, AND (4) THE SURETY SHOULD AND COULD HAVE PAID THE LOSS TO THE BANK, BECOME SUBROGATED TO ITS RIGHTS, AND ATTEMPTED TO SALVAGE THE LOSS IF IT DESIRED.

We think we have established that the loss contemplated by the bond arose when the checks were paid; that the bank was under no obligation to proceed against the endorsers on the checks

or otherwise attempt to recoup its loss, and yet the petitioner contends that by recrediting the amount of the checks to the depositor's account the obligation of the surety company was discharged.

Under such a bond as this the bank is not required and ought not to be required to engage in litigation with its depositor under the facts appearing in this record.

This is aptly stated in the opinion of the Circuit Court of Appeals in the following language:

> "We think, therefore, that the policy should be read as indemnity against the original loss, and not as holding the liability in the air until it can finally be determined whether the bank had a right to make the charge back. It is not reasonable to suppose that bank intended to buy that kind of indemnity. Banks wish to keep their depositors, not to alienate them. They would desire protection against the payments induced by forgery, not against the uncollectability of claims resulting from such payment."

The opinion further reads as follows:

> "We hold now only that the bank is not obliged to contest with the depositor any plausible claim by the latter that it has not become liable for the loss; and that, if there is any reasonable ground of litigation, the bank is not obliged to carry the burden of the resulting controversy."

Litigation between the bank and the depositor would have been hazardous as to the outcome, and the bank would probably have been unsuccessful because (a) a depositor is under no duty to examine cancelled checks for forged endorsements. National City Bank of Chicago, Ill. v. Third National Bank of Louisville, Kentucky, 177 Fed. 136 (at page 140). Jordan-Marsh Co. v. National Shawmut Bank, 201 Mass. 397, 87 N. E. 740, 22 L. R. A. (N. S.) 250 (at page 255); Welsh v. German American Bank, 73 N. Y. 424, 29 Am. Rep. 175; Shipman v.

Bank of State, 126 N. Y. 318, 27 N. E. 373, 12 L. R. A. 791; Annotations, 67 A. L. R. 1125, and 15 A. L. R. 166;

And (b) notice to depositor's agent having a hostile personal interest is not notice to the depositor. American Surety Co. v. Pauly, 170 U. S. 133;

And (c) even though the depositor were negligent in examining the cancelled checks, if the bank were negligent in paying the checks the depositor would prevail. Union Tool Co. v. Farmers & M. National Bank, 192 Cal. 40, 218 Pac. 424, 28 A. L. R. 1417; Coleman Drilling Co. v. First National Bank (Texas), 252 S. W. 215; Glassel Development Co. v. Citizens National Bank, 191 Cal. 375, 216 Pac. 1012, 28 A. L. R. 1427; U. S. v. National Bank of Commerce, 205 Fed. 433, 7 C. J. 688.

Had the depositor prevailed in the litigation with the bank it would in all probability have been too late under the terms of the bond for the bank to recover thereunder, as we have hereinbefore pointed out, and the surety company should and could have paid the loss to the bank, stepped into the bank's shoes, become subrogated to all of its rights, and have attempted to recoup the loss if it saw fit.

As stated in the opinion of the Circuit Court of Appeals, "it would be most unfortunate for such an issue to be tried in a case to which the depositor was not a party, and where it would not be bound. Whether the surety company could have brought in the depositor as a party, or could recover against it, we need not consider."

In conclusion we submit that the Circuit Court of Appeals has correctly construed the bond under consideration, which was

written by the surety company, and should be most strongly construed against it, and that there is no occasion for the judgment of the Circuit Court of Appeals being reviewed by writ of certiorari, and we therefore respectfully ask that the petition for the writ of certiorari be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM 1931

No. 413.

THE AETNA CASUALTY AND SURETY COMPANY,
Petitioner,

v.

PHOENIX NATIONAL BANK & TRUST COMPANY,
Respondent.

BRIEF FOR RESPONDENT.

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36227.

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BRIEF FOR RESPONDENT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States.

OPINION BELOW.

The opinion below is found in 44 Federal (2nd) 511 (C. C. A. 6th, 1930).

STATEMENT OF FACTS.

Of date November 14, 1923, the petitioner, The Aetna Casualty and Surety Company (hereinafter called "surety company"), executed and delivered to the respondent, Phoenix National Bank & Trust Company (hereinafter called "the bank"), its bond, which

by payment of premiums was continued in force from noon of its date until April 8th, 1926, whereby it agreed with bank to indemnify and hold it harmless from and against any loss sustained by bank "through the payment, whether received over the counter or through the clearing house, or by mail, of forged or raised checks or (genuine) checks bearing forged endorsements, or the establishment of any credit to any customer on the faith of such checks."

From a time prior to May 12th, 1924, the Petroleum Company, a corporation, was a depositor in the bank; and from prior to May 12th, 1924, until August 1st, 1925, one H. D. Fulton was Vice President and Treasurer of said Petroleum Company, and a member of its Board of Directors, and the clerk in sole charge of its books of account, check books, pass books, bank statements and the like, and was entrusted with the duty of preparing checks to be drawn upon its account at the bank. The persons who had authority to sign checks for Petroleum Company were Felix M. Miles, its President, and J. Fred Miles, his brother, who, however, was not an officer of the company.

Between May 12th, 1924, and July 28th, 1925, Petroleum Company drew thirty-nine checks on the bank, and Fulton forged the payee's endorsements on thirty-five of these checks, raised twenty-two, and changed the name of the payee, substituting the name of another, in nine, forging the endorsements of substituted payee in said nine checks. These checks were all paid by the bank upon presentment, and thirty-one of them, aggregating $3,650.95, were presented by and paid to other continuing solvent banks, and bore their endorsements. On August 7th, 1925, the frauds of Fulton were discovered, and

shortly thereafter reported to surety company, and an audit of the books of Petroleum Company was begun, at which a representative of surety company was present.

All of the thirty-nine checks in question were prepared for signature of the drawer by Fulton, and were completed in writing by him before signature except that the line for the application of the protectograph was left blank, and they were signed before the application of the protectograph to them. Fulton was trusted to fill in the line stating the amount of the check with the protectograph, and was charged with the duty of delivering the checks to the payees named therein.

The bank furnished regular monthly statements to its said depositor, together with cancelled checks charged to its account during the month.

After receiving notice surety company denied liability to the bank upon the bond sued upon, and requested that the bank notify prior endorsers and call upon them for payment of the raised or forged checks.

The bank stated to surety company that if it would agree to pay bank's claim it would immediately, if surety company so desired, make prompt demand upon the endorsers of the checks, for the surety company, for payment of said checks by reason of their endorsements thereon (R. 61).

Thereafter, on January 14, 1926, bank made an entry upon its books recrediting the account of the depositor with the sum of $5,512.72, the amount which it had originally charged to it on account of the raised or forged checks, and on February 3, 1926, began this action to recover said sum of $5,512.72.

The case was tried in the United States District Court for the Eastern District of Kentucky upon the pleadings and a stipulation of facts, and resulted in judgment for the petitioner. Upon appeal the United States Circuit Court of Appeals for the Sixth Circuit reversed the judgment and afterwards denied a petition for rehearing.

ARGUMENT.

I.

Under the Law of Kentucky Which Governs this Contract of Insurance, and Generally, the Relation Between Bank and Depositor is that of Debtor and Creditor, and the Bank Paid Out Its Own Money on the Checks Raised or With Forged Endorsements.

The long established relation of a bank to its depositor is that of debtor and creditor, and the money deposited in the bank is the property of the bank and the bank owes the depositor therefor. When a depositor draws a check on the bank the check constitutes his order on and authority to the bank to discharge this debt, *pro tanto*, by payment according to such order and authority. When the check is raised or an endorsement is forged it is no longer an order upon or authority to the bank to pay, and where the bank mistakenly, or even negligently, pays such check it is paying out its own money and not money which it is entitled to charge against its depositor as *pro tanto* payment of its debt to him.

In the case of Henderson Trust Company v. Ragan, 21 Ky. Law Rep. 601, 52 S. W. 848, the court said:

"The rule is well settled that, if a bank pays a check on a forged endorsement, it must sustain the loss. Tied. Com. Paper, par. 449. Where money is paid upon a pretended, not a real endorsement of the name of the payee, in law, the check remains unpaid and can not diminish the funds of the borrower in the bank or the money in the pocket of the person entitled to the payment. Bank v. Whitman, 94 U. S. 347."

In Rice v. Citizens National Bank, 21 Ky. Law Rep. 346, 51 S. W. 45, the court said:

"A deposit in bank of an ordinary deposit creates the relation of debtor and creditor. * * *. It is immaterial whether this deposit of $700.00 be treated as a general deposit or as a deposit for a special purpose other than bailment. The money was paid out precisely as the special instructions with the deposit provided, except that the signatures of the payees of the checks were forged. The principle seems to be well settled that a payment by a bank of a check to any person save the payee himself, except it be payable to bearer, is a payment at its peril. If the signature of endorsement is genuine, it is a payment out of the depositor's fund; if it is forged it is a payment out of the bank's funds and the depositor can not be charged with it. Shipman v. Bank (N. Y. App.), 27 N. E. 371; Hatton v. Holmes (Cal.), 31 Pac. 1131; Bank v. Whitman, 94 U. S. 347; Bank v. Morgan, 117 U. S. 112; Bank v. Burke (Ga.), 8 S. E. 739, and many other cases * * *. We conclude that the bank is liable to appellants for this deposit. The payment on a forged check was a payment by appellee at its peril. It was not a payment of appellant's funds, however great the care used by the appellee. It is not a question of care or negligence. The pay-

ment was not to the payee of checks but a payment on what purported to be his order. The order (endorsement on the check) was a forgery. For this payment appellants are in no way liable. There was no relation of principal and agent between the appellants and appellee. It was pure debtor and creditor."

To the same effect is the case of Leather Manufacturers National Bank v. Morgan, 117 U. S. 96, 29 L. Ed. 811.

The opinion of the Circuit Court of Appeals in this case states the rule as follows:

> "The relation between banker and depositor is that of debtor and creditor. The money with which the check is paid is the money of the bank. Its contract with the depositor only entitles it to charge back to, and collect from, the depositor the amount of a valid check so paid. When it pays a forged check it has no right to make this counter-charge, and its loss continues to be its loss."

II.

The Loss Covered by the Bond was the Loss of the Bank's Own Money Paid on the Checks, Raised or With Forged Endorsements, and this Loss was Sustained When Such Checks Were Paid, Irrespective of Any Possible Right of Recoupment, in Special Cases, by Future Implied Ratification by the Depositor, Estoppel of the Depositor to Assert the Forgery, or Recourse Upon Responsible Endorsers to Whom the Money Thereon Has Been Paid.

The real question for decision in this case is whether the loss covered by the bond is that sus-

tained by the bank as and when the various checks, raised or with forged endorsements, were paid. We submit that the loss against which the bank contracted for protection is a loss of its own money which it mistakenly or negligently pays on raised checks or those with forged endorsements. The intent of the parties that the loss covered is incurred by the bank at the time of payment is fortified by the fact that the deposits of a bank are payable on demand, and that the bank is under a necessity of maintaining its deposit fund unimpaired. When its deposit fund is depleted by a mistaken payment of forged checks it is essential that it be restored immediately upon learning of the loss, and such restoration it provides by its contract of insurance. The bond or contract of insurance sued on herein requires a written notice as soon as possible after the bank learns of the loss, the filing of itemized proof of claim within ninety days, and limits action on the policy to one year after learning of the loss. This clearly contemplates that the loss covered by the bond occurs at the time of payment of the checks.

In the case of Fitchburg Savings Bank v. Massachusetts Bonding & Insurance Company, 174 N. E. 324 (Mass. 1931), a question very similar to the one presented here arose. The suit was upon a "banker's blanket bond." By certain methods we need not relate the Treasurer of the insured bank, through his fraud and dishonesty, abstracted from the bank about $50,000.00, and the bank in the transaction received several notes with endorsers thereon. The surety company contended that the loss covered by the bond was the net amount irrecoverable after all rights against others than the surety company had been exhausted. The court said:

> "In this bond the word 'loss' means the deprivation or dispossession of money or property of the bank due to the dishonest criminal or fraudulent acts of its officers; regardless of the security the bank has for the loss, and that the 'loss' occurred and was suffered by the plaintiff, without regard to its possible remedies, when its funds in fact were diverted on October 8, and 10, 1925, through the fraud and dishonesty of its treasurer. Forbes v. Manufacturers' Ins. Co., 1 Gray 371; Queenan v. Palmer, 117 Ill. 62, 619, 629, 7 N. E. 470, 613; Mitchell Grain & Supply Co. v. Maryland Casualty Co., 108 Kan. 379, 384, 195 P. 978, 16 A. L. R. 1488; First National Bank of Crandon v. United States Fidelity & Guaranty Co., 150 Wis. 601, 607, 137 N. W. 742; American Surety Co. of New York v. Lawrenceville Cement Co. (C. C.) 96 F. 25, 30; Champion Ice Manuf. & Cold Storage Co. v. American Bonding & Trust Co., 115 Ky. 863, 874, 75 S. W. 197, 103 Am. St. Rep. 356."

In construing the language of the bond so as to thus define the loss covered thereby, the Court said:

> "The evidence would not warrant a finding that the plaintiff had exhausted every remedy it has against Nichols and the indorsers on the notes. It is, therefore, the contention of the defendant that the plaintiff has sustained no loss, or if it has, that it can recover nominal damages only.
>
> "A definition of the loss for which the defendant as surety is liable as the net amount irrecoverable after all rights against others than the surety have been exhausted clashes with several sections of the bond. Section 6 provides that '* * * the Underwriters upon payment of any loss hereunder shall become subrogated to

all the rights and remedies of the Insured in respect of such loss.' Section 9 provides: 'At the earliest practicable moment, and at all events not later than ten days, after the Insured shall discover any loss hereunder, the Insured shall give the Underwriter notice thereof by registered letter or telegram. * * * Legal proceedings for recovery of loss hereunder shall not be brought * * * after the expiration of twelve months from the discovery of such loss. If any limitation embodied in this paragraph is prohibited by any law controlling the construction hereof, such limitation shall be deemed to be amended so as to be equal to the minimum period of limitation permitted by such law.' Under the provisions of the contract it is obvious that the definition of 'loss' suggested by the defendant as the measure of its liability under its contract with the plaintiff might result in denying the insured a remedy altogether through its inability to exhaust its rights against third persons within the limitations of time allowed in the bond for bringing actions against the defendant. It is plain such a result unless absolutely required should not be held to express the intention of the parties. American Surety Co. v. Pauly, 170 U. S. 133, 144, 18 S. Ct. 552, 42 L. Ed. 977."

In the light of the above decision, an examination of the terms of the bond involved in the present case discloses that the loss insured against is that which arose when the checks were paid "regardless of the security the bank has for the loss and * * * without regard to its possible remedies."

In addition to the provisions requiring the insured to give written notice of any loss as soon as possible after learning thereof, and to file an itemized sworn proof of claim within ninety days after learning of such loss, and that no action should be brought under

the bond in regard to any loss unless begun within twelve months after the insured shall learn of such loss, the bond gives the surety company the right to terminate it by thirty days' written notice to the insured. If the construction of the bond contended for by the petitioner is correct, that the loss covered by the bond does not arise upon the payment of the forged check but upon an adjudication of liability of the bank to the depositor, and upon payment to the depositor of this adjudged liability, then the surety company could well cancel the bond after knowledge of the payments upon the forged checks, and before a repayment or recredit to the depositor occurred, and then contend that the loss occurred after the termination of the policy.

Should a bank omit notice to the insurer when it first learns of the mistaken payment of its money upon forged checks, and only give notice after it had learned, as the result of protracted litigation with a depositor or endorser, that it could not recover from them, it is certain that the surety company would contend, and the court hold, that the notice was too late and that the loss had occurred when it first made the payment and not when it was finally determined that the bank had irrecoverably lost money by such payment. The bond does not contemplate any such vague and uncertain time for learning of the loss and giving notice. It clearly contemplates that the loss occurred at the time of payment.

The only provision in the bond involved in the Fitchburg Savings Bank case, cited *supra,* of those referred to by the court as supporting its conclusion that the loss covered by the bond occurred when the bank's funds were diverted and paid out, with-

out regard to the security the bank has or its possible remedies, which is not found in substance in the bond in the present case, is that which provides that the insurer shall, upon payment of any loss, be subrogated to the rights and remedies of the insured without respect to such loss. The absence of such a provision is not material, because, as a matter of law, the insurer has such right. On this point the Circuit Court of Appeals said;

> "If the Surety Company could get the benefit of any rights the bank had to recover its loss, or part of it, from others, it would be by paying the loss and acquiring these rights through subrogation. (Travellers Co. v. Great Lakes Co., —C. C. A. 6,—184 Fed. 426, 430; U. S. Fidelity Co. v. Union Bank,—C. C. A. 6—228 Fed. 448, 452). The Surety Co. was doubtless entitled itself to give the necessary notices. Its request to the bank to do so was not in connection with any offer to pay up its liability, so that it might be entitled to have them given for it; the request was in connection with a denial of all liability."

In Sprague v. West Hudson County Trust Co., *et al.*, 92 N. J. Eq. 639, 114 Atl. 344, it appears that a party who had endorsed checks to which a prior endorsement was forged, filed an action against the banks on which the checks were drawn and which had paid them, and against the drawer of said checks, to restrain the defendant banks from repaying or recrediting to its said depositor the amount of such checks paid by the banks on forged endorsements, until a court of competent jurisdiction had determined that the banks were legally liable thereon. The basis for this action was that the depositor had

been negligent in the examination of its vouchers and bank statements, and the relief prayed for was that the banks be restrained from repaying to the depositor the amounts of the checks paid by them on forged endorsements "until a court of competent jurisdiction has determined that said defendant banks are legally liable thereon".

The court denied the relief sought and said that there was no equity in favor of the complainants; that the duty of the depositor to exercise reasonable diligence in examining the vouchers and bank statements was a duty it owed to the banks, "but we have never heard that this duty extended to others than the bank".

This case is helpful as showing that the bank's loss through payment of the checks with forged endorsements was sustained at the time of payment and created an immediate right to look to the endorsers for reimbursement without first litigating with the depositor the question whether the depositor was estopped and whether the checks were in fact chargeable to the account of the depositor.

The above case was followed and quoted with approval in First National Bank of Jersey City, for use of National Surety Company v. Merchants Trust Company, 140 Atl. 582 (N. J. 1927). The National Surety Company, having guaranteed the plaintiff bank against loss by reason of the payment of checks with forged endorsements, paid to said bank its loss by reason of paying such checks, and the bank, for the use of the surety company, filed suit against the defendant bank, which by its endorsements had guaranteed all endorsements prior to its own. There were 14 checks between August 10th, 1925, and February 1, 1926.

The defendant answered that the loss of the plaintiff bank was sustained through the negligence of the depositor to use reasonable diligence and care to discover the fraud, and that the plaintiff was reimbursed its loss by the depositor (we assume by permitting checks to be charged to depositor's account, without objection, for several months). The defendant undertook to have the depositor and the insurance company made parties plaintiff or defendant. The court refused to do this, and quoted with approval from the case of Sprague v. West Hudson County Trust Company, *supra,* in part as follows:

> "When the bank has paid on a forged endorsement it must ordinarily make good to its depositor, and then stands, as to all endorsements below that of the forger, as a holder in due course. In the present case the writers of the endorsement immediately below the forged one are seeking to intrude into the relation between the bank and its depositor by requiring the bank, for their benefit, to defend against the depositor's claim. This defense, in our opinion, is for the bank alone, and parties claiming under the payee have no right to require the bank to set it up."

The court also held that the liability of the defendant by reason of its endorsement must be tested by its contract with the plaintiff, and to that issue the surety company was neither a necessary nor proper party.

The above case illustrates that the surety company involved therein construed its bond as covering the loss which arose upon the payment of the checks, and it paid this loss to the bank on this theory, and itself sought recovery from the endorsers through

suit by the bank in its behalf. This the petitioner herein could have done and ought to have done.

In Royal Indemnity Company v. American Vitrified Products Company, 158 N. E. (Ohio) 827, a bond covering pecuniary loss of money sustained by fraud, including forgery, was executed by the appellant. Certain defalcations occurred after the execution of the bond and during its term by which prior defalcations were made good. It was held that the loss occurred when the money was originally taken and that the bond did not cover it, and the court said:

> "The form of paying one customer's account out of the money collected from another customer did not change the amount of the loss, for such loss already existed."

In Kimbell Trust & Savings Bank v. Hartford Accident & Indemnity Co., 333 Ill. 318, 164 N. E. 661, the bond insured a bank against loss by reason of having taken as collateral any forged security. Prior to the term of the bond the bank took as collateral security, to secure a note, certain forged bonds. The original note was renewed and marked paid, and subsequently there were two like renewals, the collateral remaining with the bank. It was held that the bond did not cover the loss of the bank by reason of the taking of the forged securities, as the taking occurred prior to the term of the bond.

In the case of Royal Indemnity Company v. North Texas National Bank, 25 S. W. (2nd) 822 (Texas), the bond covered loss through dishonest or criminal acts of officers, and bank's teller embezzled certain monies during the term of the bond. These embezzlements were concealed by the teller temporarily sub-

sequently withholding deposit slips and taking the money deposited to cover up and conceal the amount of the embezzlements he had already committed. The next day he would repeat the transaction by placing the deposit slip withheld by him on the previous day with the records of the bank and then withholding others in the same manner. Such transactions continued for several years.

The court held that the loss occurred within the meaning of the bond, at the time the money was actually abstracted, although the books of the bank showed no loss until after the term of the bond had expired.

III.

The Bank Was Not Required to Attempt Recoupment of Its Loss Sustained Through and at the Time of Payment of the Checks Before Proceeding Against the Insurer.

Without again quoting therefrom the case of Fitchburg Savings Bank v. Massachusetts Bonding and Insurance Company, cited *supra,* establishes that the insured need not attempt to recoup its loss before suing upon the bond and obtaining judgment against the surety company.

Under the law of Kentucky which controls this contract of insurance this rule is firmly established.

In Champion Ice Manufacturing Co. v. American Bonding Co., 115 Ky. 863, 75 S. W. 200, the court said:

> "It would be restricting the law of both insurance and suretyship to an absurd degree to say that appellee cannot be held liable until after appellant, having exhausted every other remedy or

prosecuted to insolvency any others who might be liable, is still not reimbursed. In other words, appellee's liability does not depend upon whether appellant might collect the stolen $500, from some one else. Having a right of action against the defaulter, Weitkamp, appellant has also the right of action against the guarantor of his honesty."

25 Corpus Juris 1111, reads as follows:

"A fidelity bond, indemnifying against dishonesty, is essentially an insurance contract, guaranteeing the payment, and not a mere guarantee of collection, upon which the insured can recover only after exhausting his remedies against those primarily liable."

In First National Bank v. U. S. Fidelity and Guaranty Company, 137 N. W. 744, the Court said:

"If the plaintiff were required to exhaust its remedies against Price and Eidsmoe before it could have recourse against the defendants, it might well be that it could not comply with the conditions of the bond at all, because it might not be able to enforce its remedies against these parties within the time which the bond attempts to limit for commencement of suit thereon. It appears to be quite clear that the language of the bond gives the plaintiff an absolute right to recover its loss from the surety as soon as it occurs, and not the qualified one to recover only so much of the loss as cannot be recovered from those responsible for it."

In National Surety Company v. Sheridan County, Mont., 33 Fed. (2nd) 473, the bond insured the County and its Treasurer against loss by robbery. Certain bonds of the County and County warrants were taken by robbery and the surety company contended that the bonds and warrants were non-negotiable and that the County could protect itself by refusing payment of them if presented. The Court held that the county bonds were negotiable, and with reference to the warrants said:

> "The power of the county to protect itself in case they fall into the hands of innocent purchasers is doubtful, and in any view the assured and the county are by the robbery subjected to the hazard of litigation and the expense incident thereto, and we see no way by which they can be given adequate protection against a loss which is prima facie the value of the warrants. Upon paying the loss, the appellant would be subrogated to the rights of the owners of the stolen securities, and may, by giving security and otherwise pursuing the course provided by the state statute, procure duplicates thereof and collect thereon at their maturity."

The case of First National Bank of New Jersey, etc., for use of National Surety Company v. Merchants Trust Company, cited *supra,* shows that the surety company assumed the burden of recouping the loss by paying same to the insured and filing suit in the name of the insured.

IV.

Assuming, Yet Denying, that the Loss Covered by The Bond Was Sustained by the Bank Upon the Recredit to the Depositor's Account, this Does Not Defeat Recovery in this Action as a Legal Adjudication of the Bank's Liability is Not Required.

The case of Ocean Accident & Guaranty Corporation v. Old National Bank, 4 Fed. (2nd) 753, is conclusive that the insured may recover without adjudication of its liability, as in this case, to the depositor.

In Globe Indemnity Company v. Union & Planters Bank and Trust Company, 27 Fed. (2nd) 496, (C. C. A. 6th) the Bank was indemnified against loss through misconduct of its Vice-President, who personally sold negotiable paper to other banks and agreed, within the apparent scope of his authority, that his bank would repurchase such paper when requested. It was held that no previous adjudication of the plaintiff's liability to repurchase was necessary in order to recover from the surety for the loss arising through the repurchase.

V.

The Petitioner Has Not Shown in this Record that the Recredit to the Depositor's Account Was Voluntary,—that is that the Bank Was Not Legally Liable to Make Such a Recredit—Because (a) a Depositor is Under No Duty to Examine Endorsements on Cancelled Checks for Forgery, It Has a Right to Assume that the Bank Has Ascertained the Genuineness Thereof; (b) Knowledge of the Depositor's Agent, and Officer, Committing the Fraud, is not Attributable to the Depositor; (c) Though the Depositor is Negligent in the Examination of the Cancelled Checks the Bank Must Be Free of Negligence in Paying them to Defeat Liability to the Depositor; (d) the Burden is Upon One Asserting Non-Liability of the Bank to the Depositor to Show that the Bank Was Not Negligent in the Payment of the Checks, and (e) the Delay of the Depositor in Discovering the Forgery Must Be Shown to Have Prejudiced the Bank.

Assuming, but not admitting, that the loss to the bank occurred when the recredit was made to the depositor's account, the surety company must establish that the bank was not legally liable to make such a recredit. The District Court overruled a demurrer to the petition showing the payment of the checks and the subsequent recredit, and the burden was therefore on the surety company by answer to affirmatively show that the recredit was not justified even under its theory of this case. This the surety company has failed to do because (a) the depositor is under no duty to examine endorsements on cancelled

checks for forgery, but has a right to assume that the bank has ascertained the genuineness thereof.

The case of Leather Manufacturers National Bank v. Morgan, cited *supra*, relied upon by the petitioner, was not a case of forged endorsements but of alteration of checks by raising the amount, and is not in conflict with the following cases supporting the rule stated, to-wit: National City Bank of Chicago v. Third National Bank of Louisville, Kentucky, 177 Fed. 136 (at page 140); Jordan-Marsh Company v. National Shawmut Bank, 201 Mass. 397, 87 N. E. 740, 22 L. R. A. (N. S.) 250; Welsh v. German American Bank, 73 N. Y. 424, 29 Amer. Rep. 175; Shipman v. Bank of State, 126 N. Y. 318, 27 N. E. 373, 12 L. R. A. 791; Annotations, 67 A. L. R. at page 1125, 15 A. L. R. 166.

In City of St. Paul v. Merchants National Bank, 187 N. W. 516 (Minn.), 22 A. L. R. 1221, the Court said:

> "The bank's obligation is to pay the checks only upon a genuine indorsement. The drawer is not presumed to know, and in fact seldom does know, the signature of the payee. The bank must, at its own peril, determine that question. It has the opportunity, by requiring identification when the check is presented, or a responsible guaranty from the party presenting it, of ascertaining whether the indorsement is genuine or not. When it returns the check to the depositor, as evidence of a payment made by its direction, the latter has the right to assume that the bank has ascertained the fact to be that the indorsement is genuine."

(b) The knowledge of Fulton, the forger, is not attributable to Petroleum Company, the depositor, and

notice to the depositor's said agent and officer, who has a hostile personal interest in the transaction, is not notice to the depositor of the forgeries and alterations. American Surety Company v. Pauly, 170 U. S. 133.

(c) Though the depositor is negligent in the examination of cancelled checks and bank statements, the bank must be free of negligence in the payment of such checks to defeat liability to the depositor. This rule is recognized in the Leather Manufacturers Bank case, *supra,* in which the Court said:

> "Of course, if the defendant's officers, before paying the altered checks, could by proper care and skill have detected the forgeries, then it cannot receive a credit for the amount of those checks, even if the depositor omitted all examination of his account."

Other cases to the same effect are Union Tool Co. v. Farmers & M. National Bank, 192 Calif. 40, 218 Pac. 424, 28 A. L. R. 1417; Coleman Drilling Company v. First National Bank, 252 S. W. 215; Glossel Development Company v. Citizens National Bank, 191 Calif. 375, 216 Pac. 1012, 28 A. L. R. 1427; U. S. v. National Bank of Commerce, 205 Fed. 433, 7 C. J. 688; Critten v. Chemical National Bank, 171 N. Y. 219, 63 N. E. 969, 57 L. R. A. 529.

This record shows that the names of the payee in nine of the checks had been erased and other names substituted therefor before the checks were presented to the bank for payment, also that several of the checks had the forged endorsement of Felix M. Miles, who was president of the depositor and authorized to sign checks and the bank no doubt was familiar with

his signature from the signature card, and the bank paid one of such checks on October 4, 1924, near the beginning of the fraudulent transactions.

It was held in Critten v. Chemical National Bank, *supra,* that the bank was responsible to the depositor in spite of the depositor's negligence in examining the cancelled checks, for all checks paid by the bank subsequent to the negligent payment of a certain check and the Court said:

> "That the defendant was grossly negligent in paying the check, and has only itself to thank for that loss, is apparent. But the effect of that negligence did not cease with the payment of the check. The referee might well have found that, had payment of the check been refused, or had Davis been required to obtain the indorsement or guaranty of the plaintiffs as to its correctness, the forgeries of Davis would have been exposed, and their repetition would not have occurred. That Davis was able to successfully continue from the time to his arrest a series of forgeries is as fairly attributable to the folly of the bank in paying to a clerk a check of his employers which had plainly been altered, without making inquiry as to the reason or authority for the alteration, as it was to any carelessness of the plaintiffs in failing to detect the alteration when the checks were returned to them from the bank. Since we have held that the question in the case was not one of ratification or estoppel, but that the liability of the plaintiffs to the bank was solely for the loss caused by their negligence, it is a complete answer to the defendant's claim that its own negligence contributed to the loss."

(d) The burden is upon the surety company which is asserting herein the non-liability of the bank to its

depositor, to show that the bank was not negligent in the payment of the checks. It is not sufficient for the surety company to plead and prove that the depositor was negligent in the examination of cancelled checks and in failing to discover the alterations and forgeries, it must further plead and prove that the bank was free of negligence in the payment of the checks.

In the case of Wussow v. Badger State Bank of Milwaukee, 234 N. W. 720 (Wis.—1931) the Court, after stating that it was the duty of depositor to examine his checks and statements said:

> "But it does not follow that the depositor cannot recover if the bank was itself negligent. The bank's exemption from liability in such case is dependent on its own freedom from negligence. Hamerschlag Mfg. Co. v. Bank, (C. C. A.) 262 F. 266, 271; Leather Mfgrs. Bank v. Morgan, *supra,* page 112 of 117 U. S., 6 S. Ct. 657. In the cases holding the bank exempt from liability because of the plaintiff's negligence it affirmatively appears that the bank was not negligent or the question of its negligence was not raised. If due care on the bank's part would have discovered the forgeries without the aid of the plaintiff, the bank cannot then escape its contractual liability merely because the plaintiff was also negligent. In such case the bank does not pay because previous forgeries were not reported to it. It pays because on its own negligent inspection it supposed the checks were genuine."

The Court placed upon the defendant bank the burden of proving that it was free from negligence, and in response to the argument that the burden was on the depositor to show that the bank was negligent, the Court said:

"The defendant contends that the court erred in placing upon the defendant the burden of proving that it was free from negligence. It urges that as the burden was on the bank to show plaintiff's negligence to exempt it from liability, the burden was on the plaintiff to show that the bank was negligent to relieve him from the effects of his negligence by analogy to the rule in negligence cases where the plaintiff has the burden of showing negligence and the defendant the burden of showing contributory negligence. There are cases involving recovery of unauthorized payments by banks which speak of negligence of the plaintiff and contributory negligence of the bank. But the situations are hardly analogous. The bank's claim in such cases is that the depositor is in equity estopped to assert that the bank is absolutely liable because the defendant's conduct has caused or contributed to the bank's payment of the forged check. But it is not unjust to require as a prerequisite condition to asserting such estoppel that the bank show that it was itself free from negligence. The right to assert an estoppel in equity does not arise unless the one asserting it has acted with due diligence. Due diligence being necessary to enable one to assert an estoppel, the bank must show due diligence before it can assert the negligence of the depositor. The whole doctrine of estoppel is a creation of equity and is governed by equitable principles. Pomeroy, Equity Juris, (4th Ed.) 813. The bank's freedom from negligence is treated as a 'preliminary question' in 3 Ruling Case Law, p. 539; National Dredging Co. v. Bank, *supra*, pages 607, 611, of 6 Pennewill, 69 A. 607. It is expressly held in Morgan v. The United States Mortgage & Trust Co., 208 N. Y. 218, 222, 101 N. E. 871, L. R. A. 1915D, 741, Ann. Cas. 1914D, 462, and Union Tool Co. v. Farmers, etc., Bank, 192 Cal. 40, 218 P. 424, 427, 28 A. L. R. 1417, that 'before a defendant bank will become en-

titled to escape its liability for payment of a forged check it must be shown that the bank itself was free from negligence,' notwithstanding that in California and in New York since 1920 as we infer, the burden of proving contributory negligence in negligence cases is on the defendant."

The case of Coleman Drilling Company v. First National Bank, *supra,* is to the same effect.

(e) The delay of the depositor in discovering the forgeries and alterations must be shown to have prejudiced the bank before the bank can escape liability for payment of the checks.

The Leather Manufacturers case, *supra,* apparently lays down the rule that prejudice to the bank will be conclusively presumed, but in that case the court authorized recovery upon the two checks last paid by the bank in the chain of forgeries, because the forgeries were discovered before the bank statement with these cancelled checks was delivered to the depositor. Under that rule regardless of all other questions the respondent bank was liable to the depositor for the checks paid during the month of July, 1925, amounting to $500.00.

Under Critten v. Chemical National Bank, *supra,* the depositor could recover from the bank for the checks paid during the first month of the payment on the forgeries and alterations. Applying this rule and regardless of any other question, respondent bank was liable to the depositor for $602.80, the amount paid by the bank during the month of June, 1924, the cancelled checks for which were returned to the depositor on or about July 1, 1924.

And many cases hold that the delay in discovering and reporting the forgeries and alterations will not

relieve the bank unless a loss or prejudice thereby is shown. Maryland Casualty Company v. Dickerson, 213 Ky. 305.

In U. S. v. National Exchange Bank of Providence, 214 U. S. 302, it is held that the right of recovery from a prior endorser of checks bearing forged endorsements is not conditioned on either demand or giving notice of the forgery. The federal rule seems to be established that irrespective of delay there is a right of recovery upon the warranty of genuineness of the endorsement which continues until barred by the Statute of Limitation. If this be the rule, the bank, as to checks aggregating $3650.95, was not prejudiced by the delay of the depositor in discovering the forgeries because solvent banks had endorsed these checks subsequent to the forged endorsements, and the respondent bank and the surety company, by subrogation, could have recovered from these endorsing banks the amount of said checks.

In National Surety Company v. Manhattan Company, 252 N. Y. 247, 169 N. E. 372, 67 A. L. R. 1113, the Court held that the failure of the depositor to discover the forgery and notify the bank may have impaired the bank's remedy against the forger, but in no wise affected its remedy against the guarantors, that is the endorsers subsequent to the forged endorsements, and said:

> "since it retains, unimpaired by any neglect of the depositor, an ample remedy, to obtain full reimbursement for the payments made, since, for these reasons, the bank has suffered no damage from the depositor's neglect therefore, the bank has no cause of action against the depositor, with which it may offset the damage incurred by him

through its unauthorized act in making the payments."

And the opinion further reads:

> "In our case, since the defendant the Manhattan Bank has a remedy over against its guarantor, the Bank of America, whereby it will be reimbursed for all the moneys which it has paid out upon the forged indorsements, we think it cannot justly maintain that it has been injured by the negligence of its depositor in delaying to report the forgeries after actual discovery thereof. Therefore the plaintiff should have a recovery in full for the unauthorized payments."

The above case has application to the $3,650.95 mentioned above.

The effect of the above cases is to show that there was a real and substantial controversy between the respondent bank and its depositor whose respective claims were held on each side in good faith, and which controversy, as stated in the opinion of the Circuit Court of Appeals "was capable of leading to tedious and expensive, if not doubtful, litigation", and we might add, to a loss to the bank which would not be covered by the bonds sued on herein.

And it must be remembered that this litigation would have been in the courts of Kentucky, and that the rule which would have been applied is laid down in the case of Commercial Bank v. Arden and Fraley, 177 Ky. 520, 197 S. W. 951, holding that under the Negotiable Instrument Law of Kentucky checks are made void by material alterations except to the extent of the amounts for which they were drawn, although in the hands of a bona fide holder in due course, and that the bank is liable to the depositor,

regardless of the depositor's negligence in the execution of the checks; and further, that the delivery of the cancelled checks to the depositor, without objection on his part, does not prevent recovery from the bank. Fidelity & Deposit Company of Maryland v. O'Brien, 180 Ky. 277, 202 S. W. 645, denying that it is the duty of the insured to attempt recoupment, would also have been applied.

VI.

The Bank Would Have Incurred a Hazard Not Covered by the Bond to Have Refused to Make the Recredit Demanded by the Depositor.

The charging of the checks to the depositor's account as they were paid by the bank constituted an attempt to recoup the loss sustained by the bank as the respective checks were paid. The recredit to the depositor's account was nothing but a book entry indicating the abandonment of the attempt to recoup the loss from the depositor. Had the bank refused to make this recredit the depositor could have drawn a check on the bank for the full amount of its deposit, including therein the amount originally charged by the bank upon the payment of the checks. If the bank had refused to pay this check it would have been responsible in damages to the depositor if it was ultimately determined that the surety company was mistaken in its position that the bank was not liable to the depositor.

In Berea Bank & Trust Company v. Mokwa, 194 Ky. 556, 239 S. W. 1044, the court held that an unintentional error on the part of the bank as to the amount of the depositor's account was no defense

in an action for damages by the depositor for the banks refusal to pay a check drawn upon it. A verdict for $750.00 against the bank was upheld by the court.

In Mt. Sterling National Bank v. Green, 99 Ky. 262, 35 S. W. 911, 32 L. R. A. 568; American National Bank v. Morey, 25 Ky. Law Rep. 2151, 80 S. W. 157, and National Bank of Lebanon v. Boles, 12 Ky. Law Rep. 422, the liability of a bank to the depositor for refusal to pay checks drawn by the depositor when there is sufficient funds to the credit of the depositor is recognized.

The loss or damage to the bank in such a case clearly would not have been covered by the bond, as it would have arisen not through payment of checks with forged endorsements, but upon account of the refusal of the bank to pay the depositor's check up to the amount of the deposit.

The bond by its terms does not require the bank to engage in litigation with the depositor, nor does it require the surety company to defend any action brought by the depositor arising out of the payment of forged or altered checks. The fact that the surety company, not obligated to do so under the terms of its bond, gratuitously offered to defend a suit by the depositor, can not enlarge upon the obligations of the bank under the terms of the bond, nor cast upon it the responsibility and hazard of becoming the defendant in litigation, the outcome of which was most uncertain.

In the cases of Transylvania Casualty Co. v. Williams, 209 Ky. 626; N. Y. Indemnity Co. v. Ewen, 221 Ky. 114, and Thatcher v. Aetna Co., 287 Fed. 484, cited by petitioner, the bonds were to indemnify

against loss resulting from "claims for damages", or "from the liability imposed by law upon the assured", on account of injuries inflicted by the automobile described in the policy. In the Thatcher case the policy of insurance expressly provided that the insured could not compromise any claim against him, and the other cases cited no doubt contained a similar provision although it does not appear in the opinions.

The bond herein did not require the surety company to defend for the bank the suit which it urged the bank to cause the depositor to bring against it, nor did it obligate the surety to pay the costs to the bank incurred by such litigation or any damages awarded to the depositor. Clearly the surety company had no right to refuse payment to the bank of the loss it had incurred when the checks were paid, and thrust the bank into expensive litigation which the surety company itself should have assumed by payment of the loss and suborgation to the rights of the bank. This right of subrogation, upon the payment of the loss to the bank, the surety company would have had. Litterdale v. Robinson, 12 Wheat 594, 6 L. Ed. 740; Travellers Co. v. Great Lakes Co., 184 Fed. 426; U. S. Fidelity Co. v. Union Bank, 228 Fed. 448.

CONCLUSION.

By reason of the payment of the checks raised or with forged endorsements, the bank had three remedies it could pursue to recoup its loss, one against the depositor, based upon estoppel of the depositor, one against the endorsers subsequent to the forged endorsement, and one against the surety company upon its bond, for which the bank had paid an adequate premium. The bank, in good faith, abandoned

its effort to recoup or recover from the depositor, and refused to look to the endorsers, all after the surety company had denied liability under the existing facts. We maintain that the bank acted within its rights and in accordance with the terms of the bond when it did so, and the judgment of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

No. 413.—October Term, 1931.

The Aetna Casualty and Surety Company, Petitioner,
vs.
Phoenix National Bank and Trust Company of Lexington.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[March 14, 1932.]

Mr. Justice Stone delivered the opinion of the Court.

This suit was brought by respondent, a national bank, in the Circuit Court of Fayette County, Kentucky, to recover on a bond of indemnity issued by the petitioner. The cause was removed to the United States District Court for the Eastern District of Kentucky, which, after a trial by the court upon an agreed statement of facts, gave judgment for petitioner. — Fed. —. Judgment of reversal by the Court of Appeals for the Sixth Circuit, 44 F. (2d) 511, is here for review on certiorari. — U. S. —.

The indemnity bond, issued upon payment of a stipulated premium, undertook to indemnify the respondent for "any loss through the payment . . . of forged or raised checks or (genuine) checks bearing forged endorsements. . . ." On different dates between May 12, 1924, and June 23, 1925, while the bond was in force, a corporation depositor of respondent drew thirty-nine checks upon its deposit account in favor of third persons. The endorsements of the payee on thirty-five of the checks were forged, and the amounts payable on the other four and on eighteen others were raised by one Fulton, who was the vice president and treasurer of the depositor, having charge of its checkbooks and books of account. Authority to sign the checks was vested in the president and one other, who was not an officer of the depositor. All the checks bore genuine endorsements made subsequent to the forgeries, two of them by Fulton alone. All were paid by respondent on presentation, and the amounts paid were charged to the depositor's account. Monthly statements were rendered to the depositor, accompanied by the cancelled checks. No agents or

representatives of the depositor other than Fulton, the forger, examined the depositor's accounts, cancelled checks, or books of account. The checks were prepared for signature by Fulton. The representatives of the depositor who signed them relied wholly on him for their accuracy and for the names of the payees. All of the raised checks "were completed in writing by Fulton, except that the line for the application of the protectograph was left blank, and were signed, before the application of the protectograph to them. And Fulton was trusted to fill in the line stating the amount of the cheque, with the protectograph, and was charged with the duty of delivering the cheques, whether by mail or in person."

About August 7th, a month after the payment of the last check, the depositor gave notice of the forgeries to the respondent and demanded that the sum of $5,512.72, representing so much of the payments as were induced by the forgeries, be recredited to its account. The respondent in turn asked payment of that amount of petitioner in satisfaction of its liability on the indemnity bond. Petitioner, while admitting liability if respondent was not authorized to charge the depositor with the loss, insisted that the depositor was so chargeable because of its negligence and delay in notifying respondent of the forgeries and its negligence in drawing the checks. It offered to defend any suit brought against the respondent by the depositor with respect to the loss, and asked respondent to give notice of the forgeries to prior endorsers and to demand reimbursement from them. Respondent failed to comply with any of these requests and later credited its depositor with the disputed amount.

The petitioner, by way of defense, set up specifically the bank's assumption of the loss by crediting the depositor in the face of the latter's alleged negligence and omissions. The court below thought that the question presented was merely one of the time of the loss indemnified against, and as that had occurred when the checks were paid by respondent, later events determining the ultimate incidence of the loss as between the bank and its depositor or endorsers, were immaterial. Hence it concluded that the subsequent credit to the depositor of the amount of the loss and the consequent relinquishment of any claim against the depositor or others,

had no bearing on the liability of the indemnitor. The court said: "... in the present case, the loss was suffered and the liability arose from time to time as the checks were paid; and, when finally the bank cancelled the charges and recredited the total, it was not then suffering a loss; it was abandoning a claim for recoupment of its earlier loss—a claim which at first it did not have. We think, therefore, that the policy should be read as indemnity against the original loss, and not as holding the liability in the air until it can finally be determined whether the bank had a right to make the charge back." 44 F. (2d) 511, 512.

We think that the respondent could not relinquish any claims it might have had against the depositor and preserve unimpaired its right to the indemnity. Petitioner's undertaking "to indemnify ... and hold harmless" the respondent from any loss sustained by reason of the specified payments, contained no words indicating an intention to destroy the indemnitor's usual privilege of subrogation to the indemnitee's right to recover from any who are liable to it for the loss. That privilege was a necessary incident to petitioner's contract, for only by resort to it could the character of the contract as indemnity be preserved. It is both the object and the justification of subrogation that it makes exact indemnity the measure of the liability. See *Standard Marine Insurance Co., Ltd.* v. *Scottish Metropolitan Assurance Co., Ltd.*, 283 U. S. 284; *United States* v. *American Tobacco Co.*, 166 U. S. 468; *St. Louis, Iron Mountain & Southern Ry. Co.* v. *Commercial Union Ins. Co.*, 139 U. S. 223, 235; *Hall & Long* v. *The Railroad Companies*, 13 Wall. 367; *Jones* v. *Bacon*, 145 N. Y. 446, 450.

Even though we assume, as the court below held, that petitioner's liability attached on payment of the checks, and that respondent had none the less suffered a loss even though it might be able to recoup it from others, see *Champion Ice Mfg. & Cold Storage Co.* v. *American Bonding & Trust Co.*, 115 Ky. 863, respondent was still under a duty not to impair the rights which petitioner, upon payment of its obligation, might enforce against third persons. The failure to observe that duty, by stating an account which relinquished all claims against its depositor, see *Greenhalgh Co.* v. *Farmers' National Bank*, 226 Pa. 184, 188, released the petitioner from the liability which had already accrued. See *Sims* v. *Mutual Fire Ins. Co.*, 101 Wis. 586; *Illinois Automobile Ins. Exchange* v. *Braun*, 280 Pa. 550; *American Surety*

Co. v. *Ballman*, 104 Fed. 634; *Jones* v. *Bacon, supra.* To hold that respondent could, without affecting its indemnity, release its rights against those who might be liable for its loss would be to hold, by a parity of reasoning, that respondent could enforce them with a similar lack of effect upon its right to recover from petitioner. In either case petitioner's contract would be converted from one of indemnity, as stipulated, into an unqualified obligation to repay to the bank the amounts which it was induced to pay by the forgeries.

It is unnecessary to decide with finality what might have been the rights of the bank against other parties. It is enough to say that neither the decisions in the federal courts nor the statutes and decisions of Kentucky, which are controlling, preclude a successful defense to assertion of a claim by the depositor.[1] If the indemnitee assumes to relinquish its rights without the consent of its indemnitor, the burden rests on it to establish that they are nonexistent or unsubstantial. See *Wilson* v. *Hite's Executor*, 154 Ky. 61, 69; *Wheeler* v. *Sweet*, 137 N. Y. 435, 443.

The court below thought that it was not reasonable to suppose that the bank had intended to buy a kind of indemnity which would involve it in litigation with its depositors, since the purpose of the bank was to keep its depositors and not to alienate

[1]Carroll's Ky. Stat. (1930) §§ 3720b-124, 125, provide that material alterations avoid a negotiable instrument "except as against a party who has himself made, authorized or assented to the alteration and subsequent endorsers." These sections have been interpreted as permitting a holder to enforce the instrument where the maker has negligently left blank spaces which have been filled out in violation of the maker's authority. See Hackett *v.* First National Bank, 114 Ky. 193; Woolfolk *v.* Bank of America, 73 Ky. 504; Blakey *v.* Johnson, 76 Ky. 197, 204; Cason *v.* Grant County Deposit Bank, 97 Ky. 487; Diamond Distilleries Co. *v.* Gott, 137 Ky. 585. Compare Commercial Bank *v.* Arden & Fraley, 177 Ky. 520; Maryland Casualty Co. *v.* Dickerson, 213 Ky. 305; Rice & Givens *v.* Citizens National Bank, 21 Ky. L. R. 346. And see Champion Ice Mfg. & Cold Storage Co. *v.* American Bonding & Trust Co., 115 Ky. 863, 874-875; London Joint Stock Bank, Ltd. *v.* MacMillan & Arthur, [1918] A. C. 777.

As to the possibility that the depositor may have been estopped to assert a claim against the bank, because of negligence in examining its statements and accounts, see Leather Manufacturers' Bank *v.* Morgan, 117 U. S. 96; Empire Trust Co. *v.* Cahan, 274 U. S. 473, 479-480; Critten *v.* Chemical National Bank, 171 N. Y. 219.

them. As the liability had already attached on payment of the checks, the bank might have sued its indemnitor at once, and was not called on to defend itself against claims of its depositor or to prosecute its own claims against the endorsers. *Insurance Co.* v. *Stinson*, 103 U. S. 25. But it could not, as it has sought to do, retain its indemnity and withhold from its indemnitor the privilege of contesting or making such claims. See *American Surety Co.* v. *The Greek Catholic Union*, — U. S. —, decided February 15, 1932. If such was respondent's object, it should have taken from petitioner not a contract of indemnity, as it did here, but one to pay to it all amounts disbursed on forged checks.

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.